Office of the Under Secretary of Defense (Comptroller) (OUSD(C))

DEPARTMENT OF DEFENSE
UNITED STATES OF AMERICA

How to Manage Audit Evidential Matter

Student Guide

Version 1.0

July 2005

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Course Title	**How to Manage Audit Evidential Matter**
Course Identification	Course Code: OSD-EM Course Type: F
Level and Type	Introductory Functional Course
Course Length	8 hours 8 CPE credit hours
Field of Study	Accounting and Audit, Government Accounting and Reporting – Specialized.
Course Description	The How to Manage Audit Evidential Matter course, Version 1.0, is an eight-hour, introductory functional course designed to teach students how to manage audit evidential matter. It also explains the legal and regulatory framework for the retention of evidential matter, and the roles and responsibilities for that retention. It describes the archival and retrieval processes including the tools available for that retrieval. Finally, it describes the presentation of evidential matter, including roles, responsibilities, processes, reports, and record keeping. Students will learn how virtually every DoD job, whether financial or non-financial, contributes to specific components of the financial statements.
Learning Objectives	Upon completion of this course, the student will be able to: • describe how to produce audit evidential matter • describe how to retain audit evidential matter • describe how to retrieve audit evidential matter • describe how to present audit evidential matter.
Presentation Mode	The primary methods of instruction are conference, questions and discussion, and a final examination.

Who Should Attend	The audience for this course is civilian and military personnel of various grades and ranks. It consists of both financial and non-financial personnel who desire to improve their operations while satisfying Congressional and regulatory audit requirements.
Prerequisites	There are no prerequisites for this course.

Course Agenda

8:00-8:10	Course Introduction
8:10-10:15	Lesson 1 – Producing Audit Evidential Matter
10:15-11:30	Lesson 2 – Retaining Audit Evidential Matter
11:30-12:05	Lesson 3 – Retrieving Audit Evidential Matter
12:05-1:05	Lunch
1:05-1:20	Lesson 3 – Retrieving Audit Evidential Matter (cont.)
1:20-3:10	Lesson 4 – Presenting Audit Evidential Matter
3:10-3:30	End-of-Course Review
3:30-4:50	Final Examination and Final Examination Review
4:50-5:00	Course Critique

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Final Examination Exam-1

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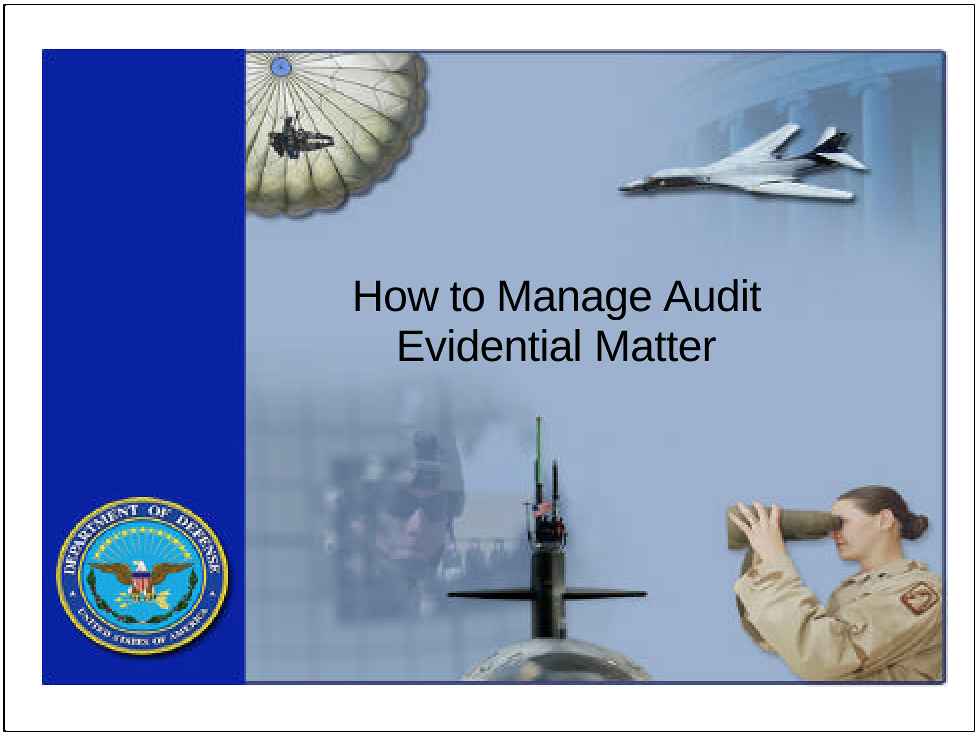
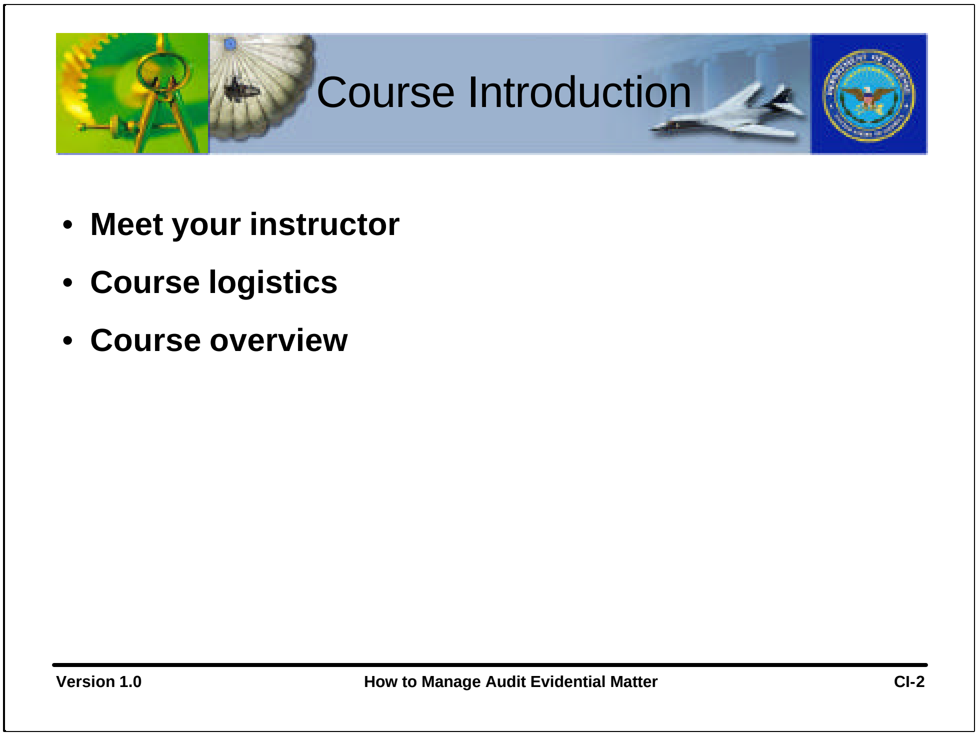


How to Manage Audit Evidential Matter

Good morning and welcome to the How to Manage Audit Evidential Matter course.

In this course, you will learn about how to produce, retain, retrieve, and present audit evidential matter.

But, before we get into more in-depth information, let’s discuss some important points.



Course Introduction

- **Meet your instructor**
- **Course logistics**
- **Course overview**

Since we are going to be together all day, I would like to start by introducing myself. I am ___________ and… (name, background, and what makes you uniquely qualified to instruct this course).

Now let’s talk about a few course logistics.

Course Logistics

Starting Time
Coffee Breaks
Restrooms
Cell Phones
Lunch Break
Phone Calls
Nondisclosure
Exercise/Exam

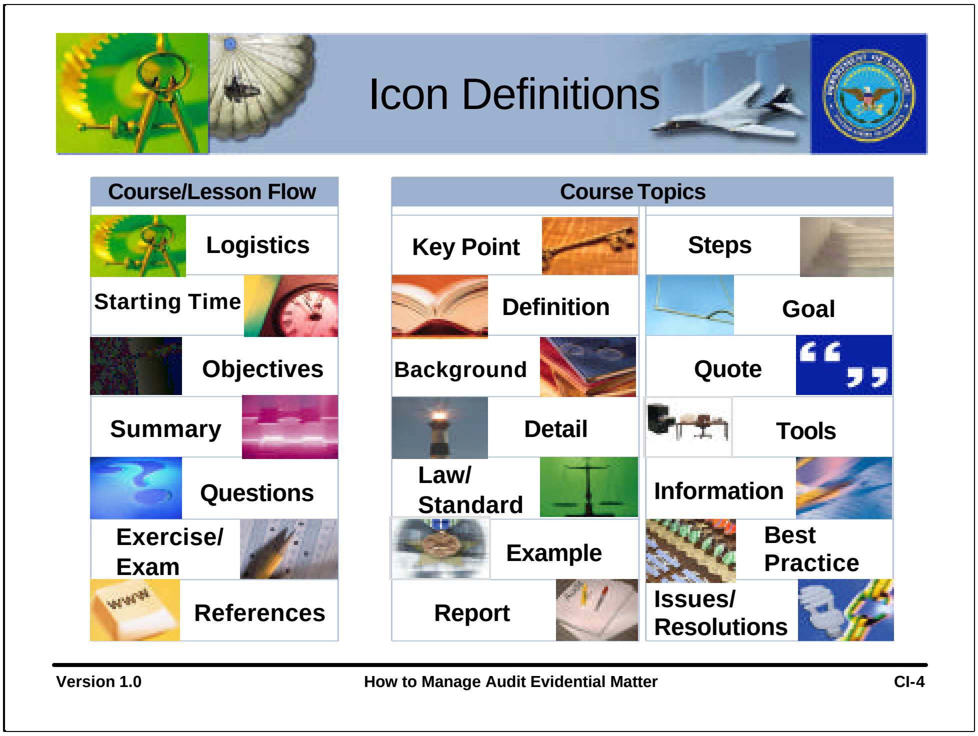
Restrooms are located at ________, and break facilities, coffee, and snacks are located at _______. Drinks and snacks are not allowed in the classroom.

Please silence all pagers and cell phones, and refrain from their use while in the classroom. If you must stay in contact, please leave the room to answer a silent page. Telephones for your use are located _____.

During this discussion, you will be provided with examples of financial transactions and other proprietary information either from the instruction or from your classmates. You must assume that this information is not for use by the general public, nor is it to be published or disseminated to third parties.

The format for this class is conference/lecture and will include questions and discussion. There are no practice exercises, but there is a final examination. You may use any materials provided in the course or discussion to complete this examination.

Let’s take a look at these materials.



Icon Definitions

Course/Lesson Flow	Course Topics	
Logistics	Key Point	Steps
Starting Time	Definition	Goal
Objectives	Background	Quote
Summary	Detail	Tools
Questions	Law/ Standard	Information
Exercise/ Exam	Example	Best Practice
References	Report	Issues/ Resolutions

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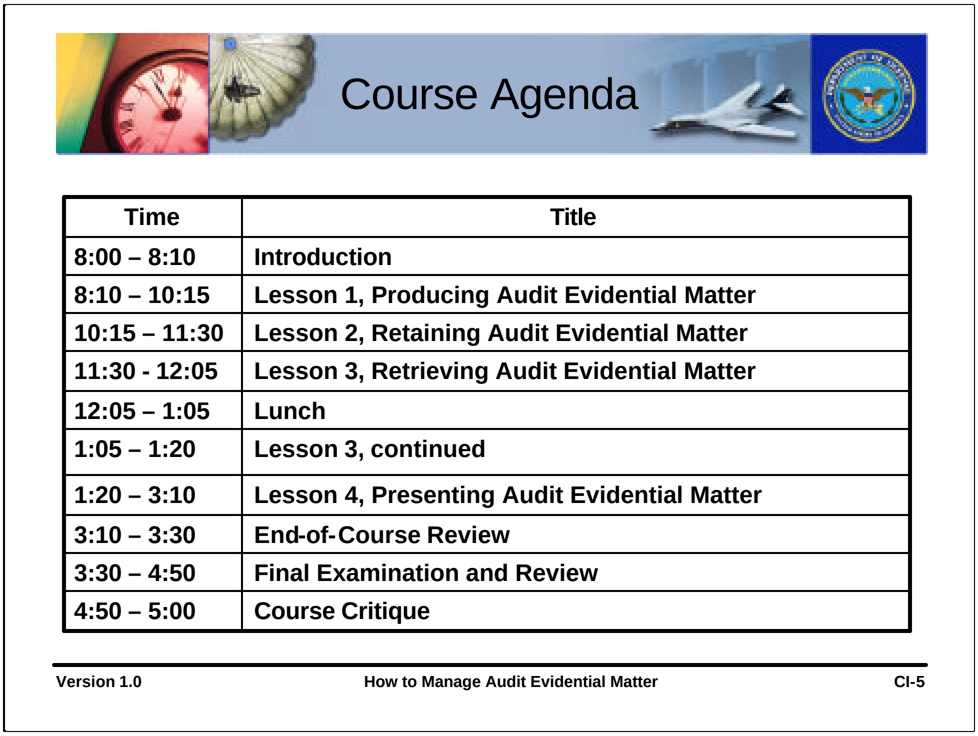
Notice that each page is formatted with a header. The left corner of each header contains an icon that provides a visual key to the contents of the page. For example, this page displays the Logistics icon.

The main icons describe course and lesson objectives and introduce key topics. Additional icons within each topic represent definitions, background information, and issues and resolutions. Best Practice and Lessons Learned icons will show examples of successful practices implemented by the government or industry. At the conclusion of each lesson, icons will represent the lesson summary, questions and answers, final examination, and links to references available for more information.

Please feel free to take notes on your student materials, and to write down any questions that you may have that we may not have had time to address during the discussion of a particular topic. Your questions are very important to us, but we may not have the answer or sufficient time available in the classroom and may have to go to an outside source for an answer.

Now let’s examine the course agenda.



Course Agenda

Time	Title
8:00 – 8:10	Introduction
8:10 – 10:15	Lesson 1, Producing Audit Evidential Matter
10:15 – 11:30	Lesson 2, Retaining Audit Evidential Matter
11:30 - 12:05	Lesson 3, Retrieving Audit Evidential Matter
12:05 – 1:05	Lunch
1:05 – 1:20	Lesson 3, continued
1:20 – 3:10	Lesson 4, Presenting Audit Evidential Matter
3:10 – 3:30	End-of-Course Review
3:30 – 4:50	Final Examination and Review
4:50 – 5:00	Course Critique

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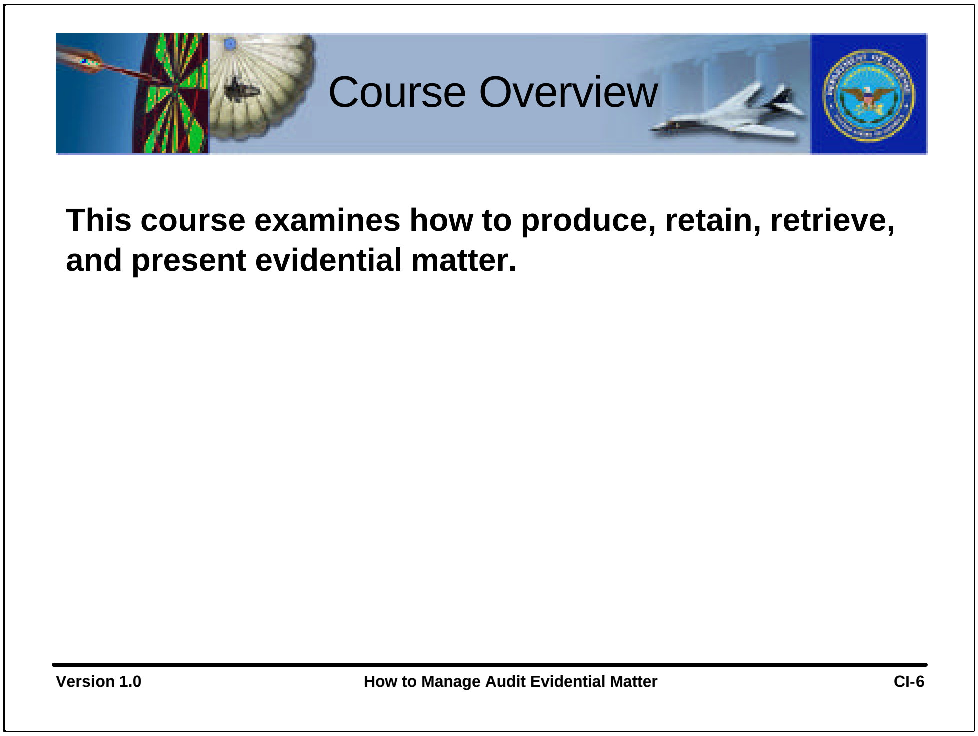
This is our road map for the day.

Class starts promptly at 8:00 a.m. and will break for ten minutes each hour.

Lunch is scheduled from 12:00 to 1:00 and class ends at 5:00 p.m.

In this course there are four lessons, an end-of-course review, and a final examination. Lessons 1 and 2 will be started and completed before lunch. Lessons 3 and 4 will begin after lunch and be completed at 3:10. The course review will follow Lesson 4 and then the final examination will be administered. Finally, you will complete a course critique and the instructor will distribute course completion certificates.

Let’s discuss the purpose and objectives of this course.



Course Overview

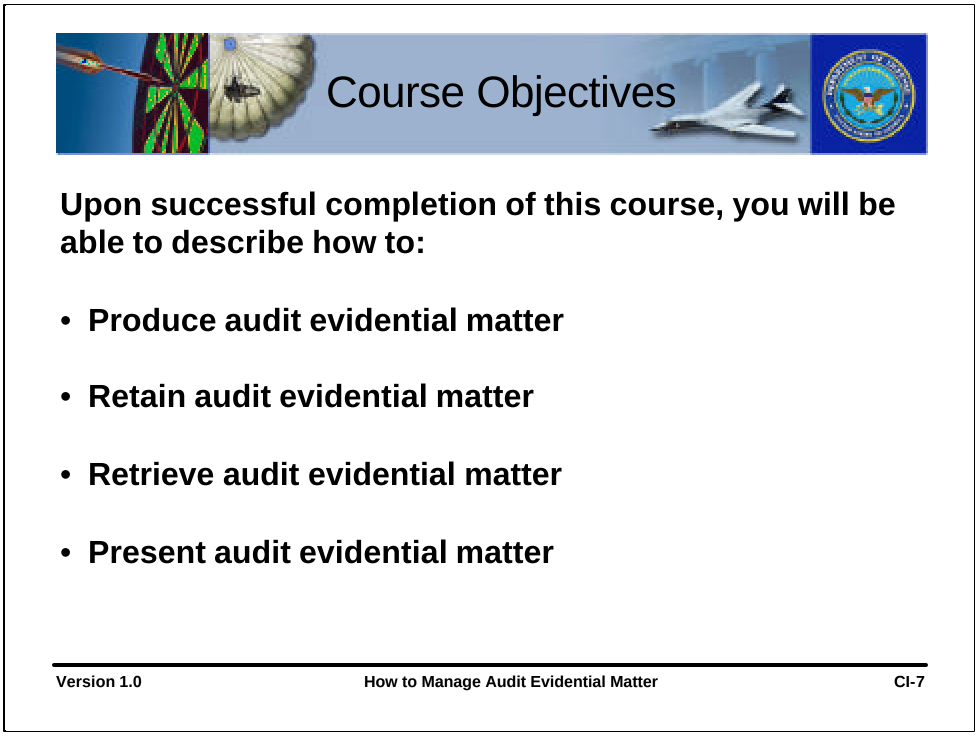
This course examines how to produce, retain, retrieve, and present evidential matter.

This course is designed to help you understand how to prepare evidential matter that relates to the annually audited financial statements. You will learn how to produce evidential matter by looking at examples of audit trails, proper source documentation and its impact on the audit trail, and substantive testing. You will differentiate between primary, secondary, and third-party evidential matter, and understand how it moves from subsidiary or feeder systems into primary accounting systems. You will see how cycle memos document internal control processes and how control activities and risks relate to internal control.

This course will look at the legislative and regulatory requirements for the retention of evidential matter and how it affects the quality of the evidence. Proper file maintenance and the processes for capturing and organizing the evidential matter so it is accessible upon request will be described. Also, the roles and responsibilities of the points of contact and the importance of storing evidential matter will be discussed.

This course will explain how to retrieve evidential matter for an audit and review the responsibilities and roles of various personnel. The Prepared by Client List will be discussed along with the use of document retrieval tools for obtaining audit evidential matter and controlling the flow and location of it. Specific guidance from the Inspector General (IG) will be presented.

Let's look at the course objectives.

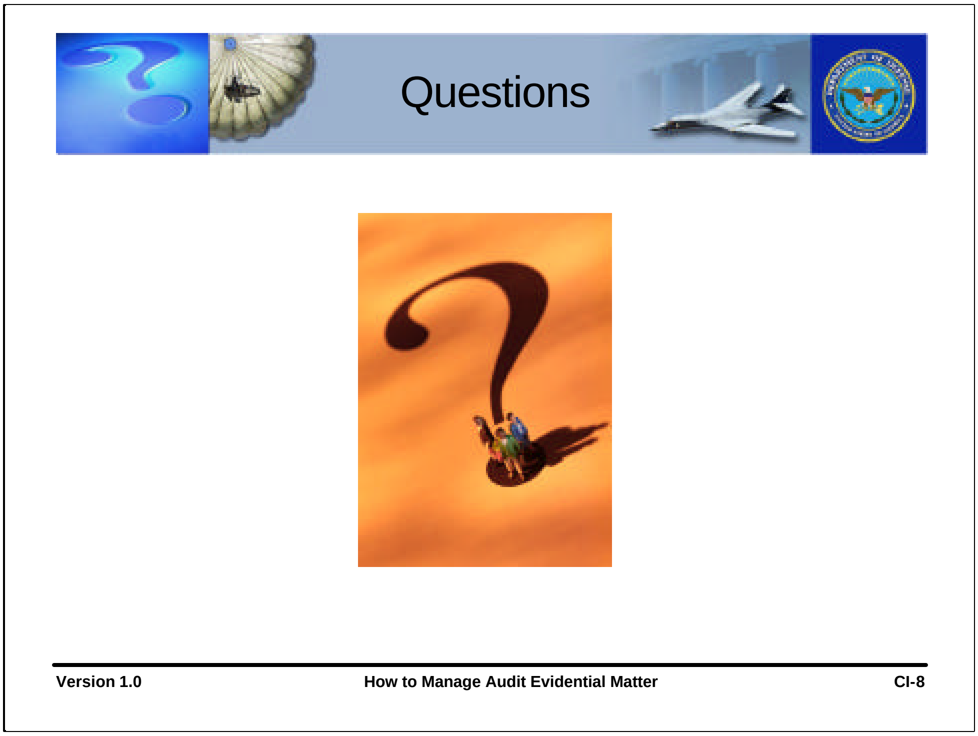


Course Objectives

Upon successful completion of this course, you will be able to describe how to:

- **Produce audit evidential matter**
- **Retain audit evidential matter**
- **Retrieve audit evidential matter**
- **Present audit evidential matter**

This course will convey the skills necessary for you to help the DoD to manage evidential matter. Upon successful completion, you will be able to describe how to produce, retain, retrieve, and present audit evidential matter.



Questions

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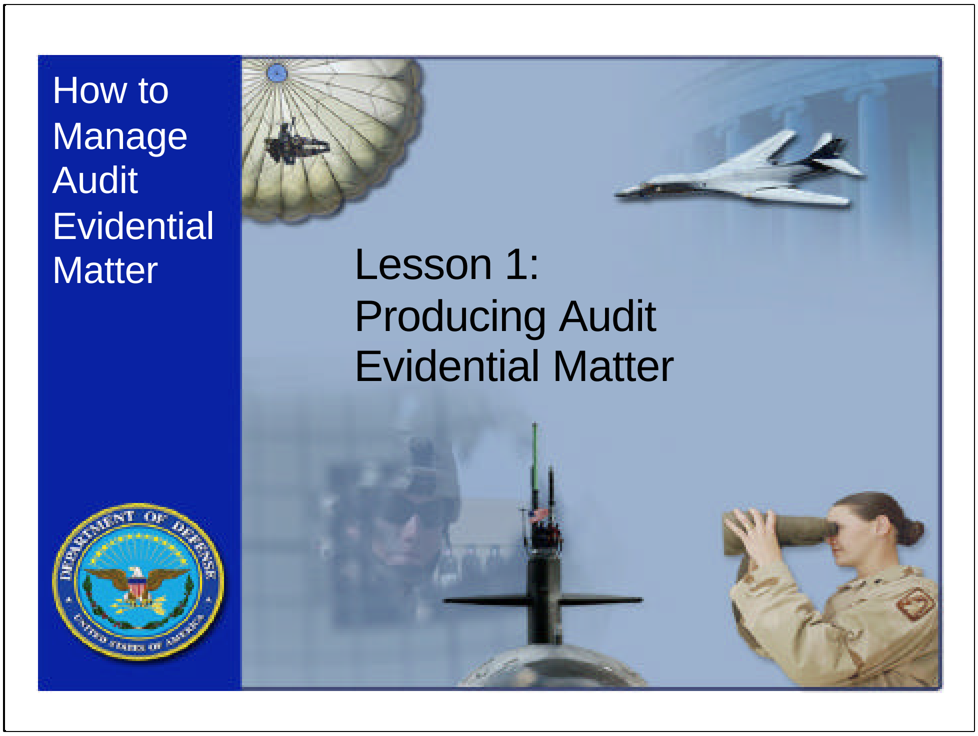
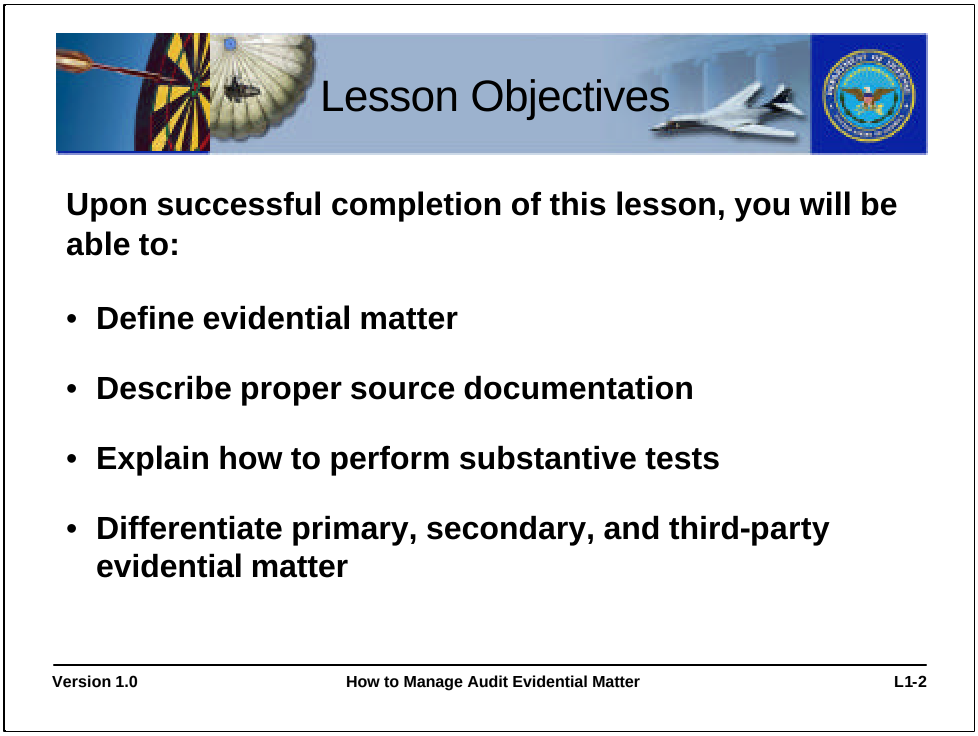
Before we proceed with Lesson 1, Producing Audit Evidential Matter, are there any questions?



How to Manage Audit Evidential Matter

Lesson 1: Producing Audit Evidential Matter

In this lesson, we will look at the types of evidential matter and how they are used in an audit.



Lesson Objectives

Upon successful completion of this lesson, you will be able to:

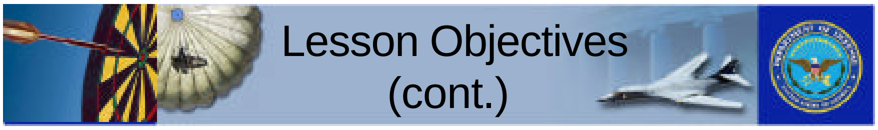
- **Define evidential matter**
- **Describe proper source documentation**
- **Explain how to perform substantive tests**
- **Differentiate primary, secondary, and third-party evidential matter**

This lesson describes the source documentation or evidential matter needed for a successful audit.

Evidential matter comes in many different forms of documentation. This lesson describes the different sources of documentation and their reliability as evidential matter based upon the classification as primary, secondary, or third party. The classification helps to determine the reliability of the data that eventually affects the financial statements.

This lesson describes data flows from subsidiary/feeder systems to the primary accounting systems. All the resulting evidential matter will be used in substantive testing by the auditors to determine if there are misstatements that result in material weaknesses.

We discuss internal controls as they relate to the evidential matter and system flows, along with the process for documenting the information in a cycle memo.

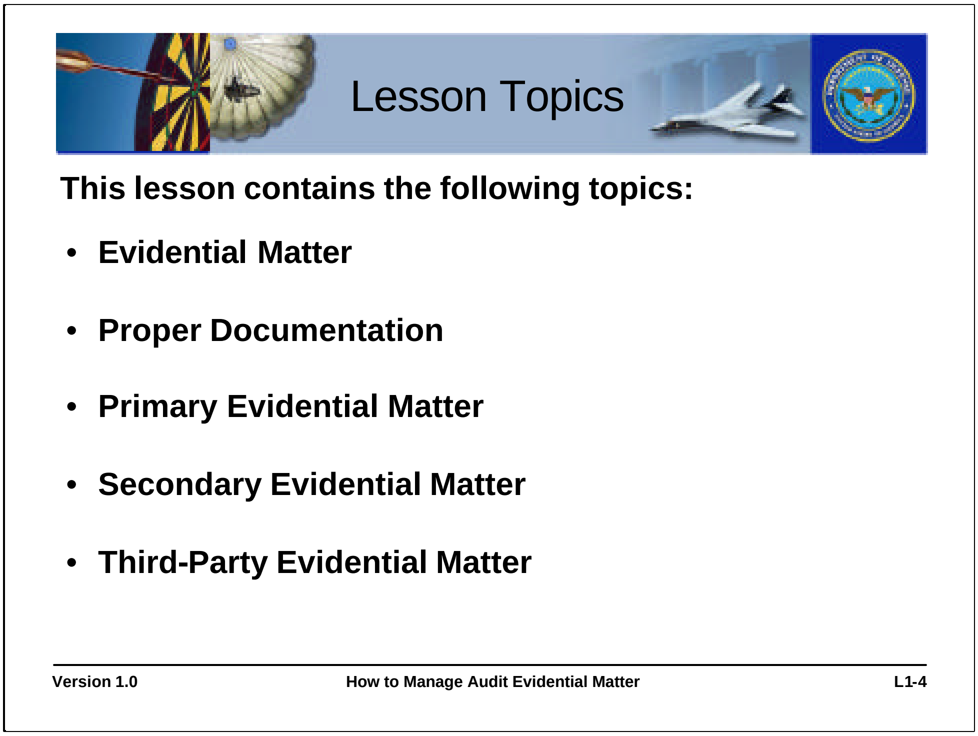


Lesson Objectives (cont.)

Upon successful completion of this lesson, you will be able to (cont.):

- **Understand system flow**
- **Explain how to produce cycle memos**
- **Identify relevant control activities**

A systems flow example is provided to demonstrate subsidiary data flowing into the primary accounting systems. We discuss cycle memos to provide you with a tool that will document your entity's internal controls. We also identify relevant control activities.



Lesson Topics

This lesson contains the following topics:

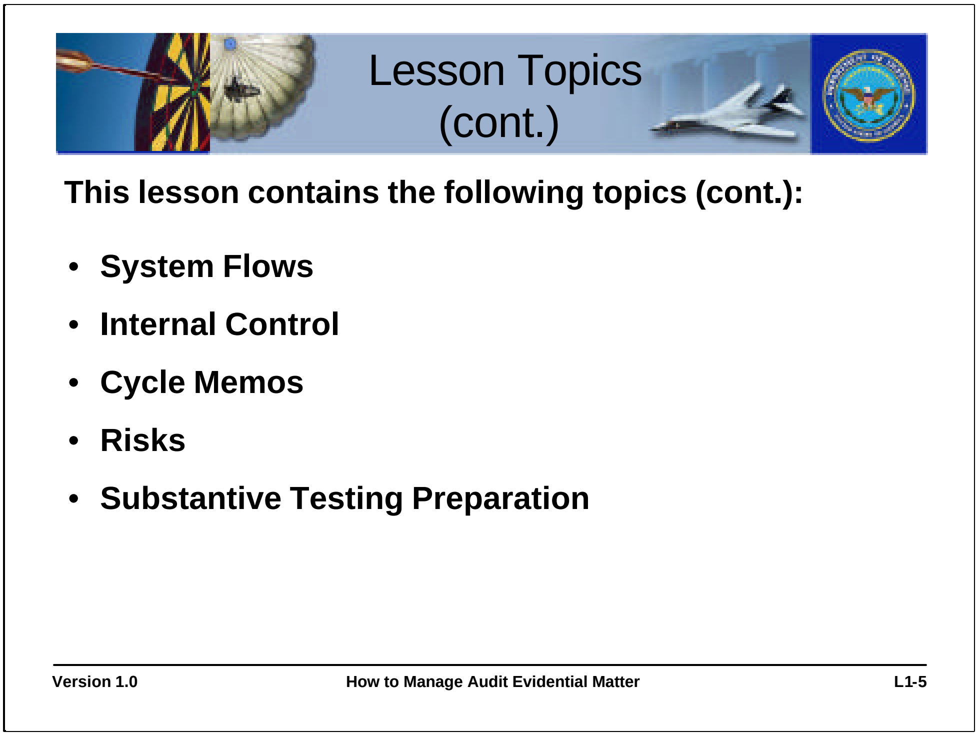
- **Evidential Matter**
- **Proper Documentation**
- **Primary Evidential Matter**
- **Secondary Evidential Matter**
- **Third-Party Evidential Matter**

This lesson contains these topics.

First, we will define the different types of evidential matter and give examples of audit trails for different transactions.

Next, we will discuss source documentation, its strength as evidential matter, and its value to the auditor’s opinion.

Primary, secondary, and third-party evidential matter will be defined.



Lesson Topics (cont.)

This lesson contains the following topics (cont.):

- **System Flows**
- **Internal Control**
- **Cycle Memos**
- **Risks**
- **Substantive Testing Preparation**

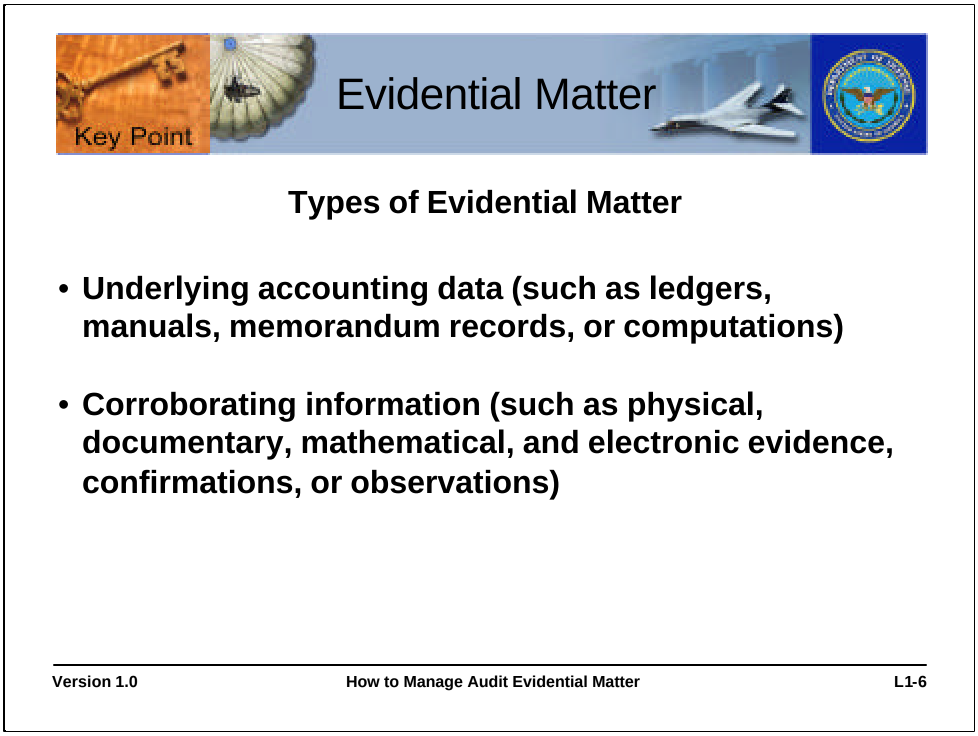
The topic on System Flows will provide you with a flowchart of subsidiary data being processed into a primary accounting system to populate the United States Standard General Ledger (USSGL).

Internal control and risks will help you to identify control activities and the risk factors.

A discussion of cycle memos will describe the components so that you can understand how to prepare them.

We will describe substantive testing, as well as the manner in which it is applied to the Balance Sheet.

Let’s begin by defining evidential matter.



Key Point

Evidential Matter

Types of Evidential Matter

- **Underlying accounting data (such as ledgers, manuals, memorandum records, or computations)**
- **Corroborating information (such as physical, documentary, mathematical, and electronic evidence, confirmations, or observations)**

Version 1.0 **How to Manage Audit Evidential Matter** **L1-6**

There are two types of evidential matter, underlying accounting data or corroborating information.

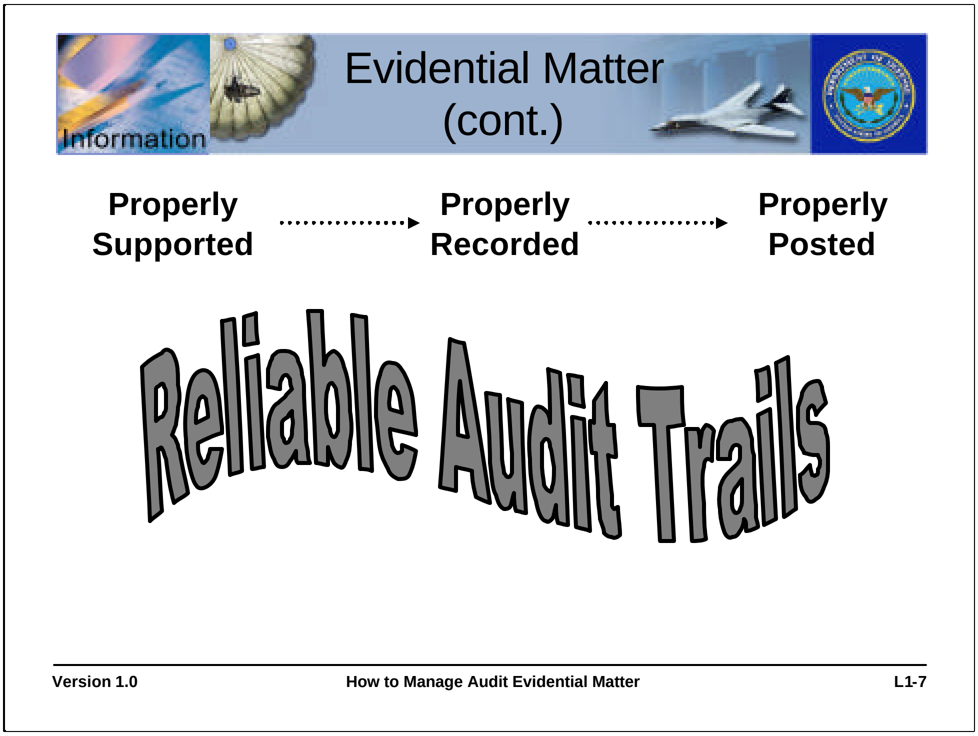
Underlying accounting data includes entries that result in information that flows to the general ledger and the supporting subsidiary ledgers, the policy and procedure manuals, and the informal and memorandum records such as worksheets, computations, and reconciliations.

During the audit, you will be required to provide the auditors with this type of evidential matter.

In addition, you will be required to provide the other type of evidential matter called the corroborating information. This data includes those items that are the basis for underlying accounting data. When auditors try to determine if the entries are reliable, they want to be provided with corroborating evidential matter to substantiate the underlying accounting data.

Systems are certified as compliant with respect to government accounting standards. When systems are non-compliant, a manual work-around is required to correct accounting data.

Let’s look at ways that an auditors obtains evidential matter.



Information

Evidential Matter (cont.)

Properly Supported → **Properly Recorded** → **Properly Posted**

Reliable Audit Trails

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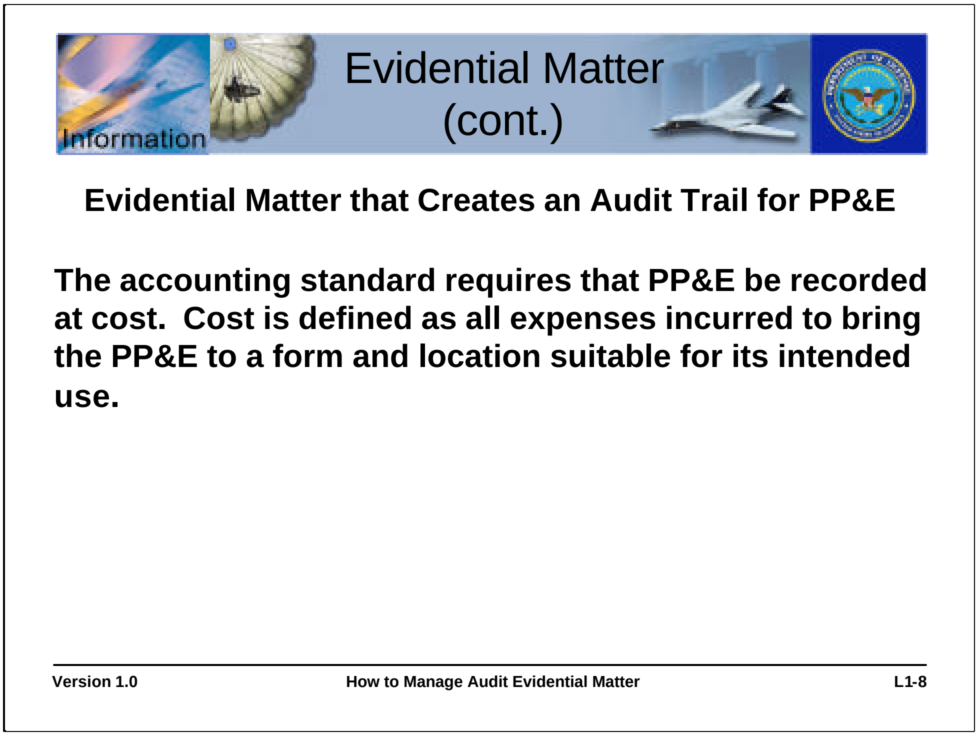
An audit trail provides sufficient information to physically track any single transaction from its inception to its appearance in the financial reports and statements and from the financial reports and statements back to the source documents. Audit trails that are properly recorded, classified, coded, and posted permit detection, tracing, and correction of rejected or suspended transactions in a timely manner.

Let’s discuss how this relates to the types of evidential matter already described as underlying accounting data or corroborating Information.

Corroborating information such as inspection, observation, inquiries (interviews), and confirmations are types of supporting evidence that is used to create an audit trail. Auditors use this documentation to verify underlying accounting data and eventually form an audit opinion.

Let’s look at examples of evidential matter audit trails from Property, Plant, and Equipment (PP&E), Environmental Liability, Operations, Maintenance, and Supplies (OM&S), Accounts Payable, Accounts Receivable, Disbursements, and on a Journal Voucher (JV), Standard Form (SF) 1081, and investment.


Information

Evidential Matter (cont.)

Evidential Matter that Creates an Audit Trail for PP&E

The accounting standard requires that PP&E be recorded at cost. Cost is defined as all expenses incurred to bring the PP&E to a form and location suitable for its intended use.

The accounting standard requires that PP&E is recorded at cost. Cost is defined as all expenses incurred to bring the PP&E to a form and location suitable for its intended use. For PP&E that was in existence prior to October 1, 1998, where historical cost information has not been maintained, cost estimates can be used.

Cost estimates are based on the cost of similar assets that were put into service at the time of acquisition or the current cost of similar assets discounted for inflation since the time of the acquisition. Appropriate documentation supporting the value for real or personal property must be maintained for the retention period specified by the National Archives and Record Administration (NARA).

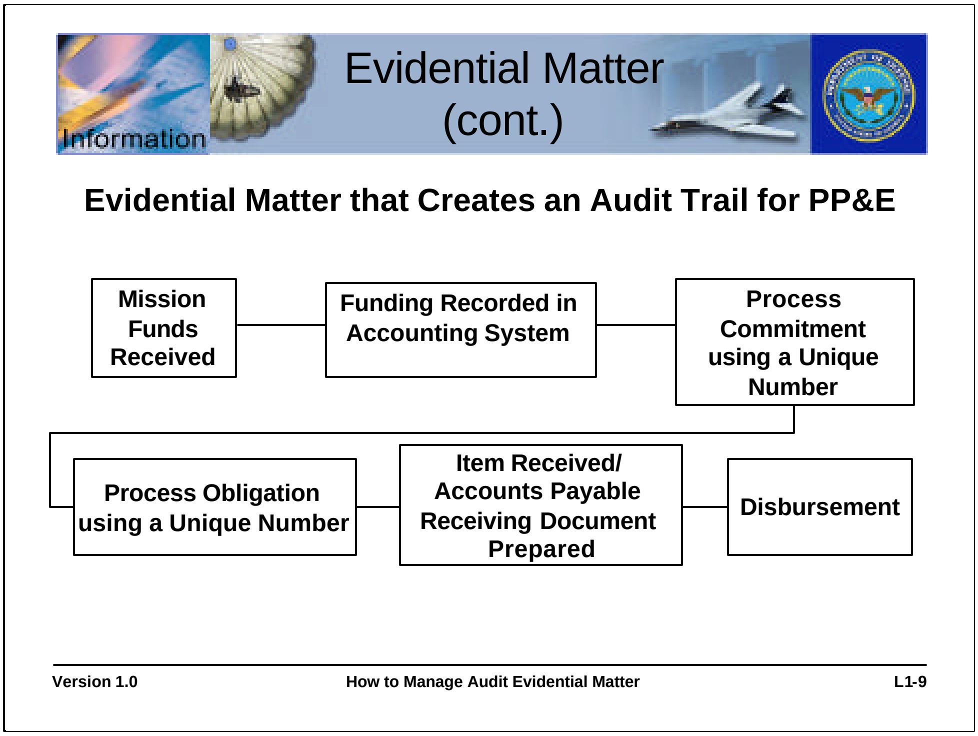
Supporting documentation for PP&E can include:

- invoices
- sales and procurement contracts
- Engineering Form 3013, Work Order/Completion Report
- construction contract work orders
- other documents generated independently by an entity.

Supporting documentation with:

- offers to sell
- purchases deeds
- condemnation proceedings.

When a purchase deed is not present then cost of similar assets at time of acquisition or cost of similar assets discounted for inflation is used.



Evidential Matter (cont.)

Information

Evidential Matter that Creates an Audit Trail for PP&E

Mission Funds Received

Funding Recorded in Accounting System

Process Commitment using a Unique Number

Process Obligation using a Unique Number

Item Received/ Accounts Payable Receiving Document Prepared

Disbursement

This slide shows an example of a PP&E audit trail. First, your activity receives mission funds to purchase PP&E. You record the funds in your accounting system. You establish a commitment record (with a unique document number) for the purchase of PP&E in excess of $100,000.

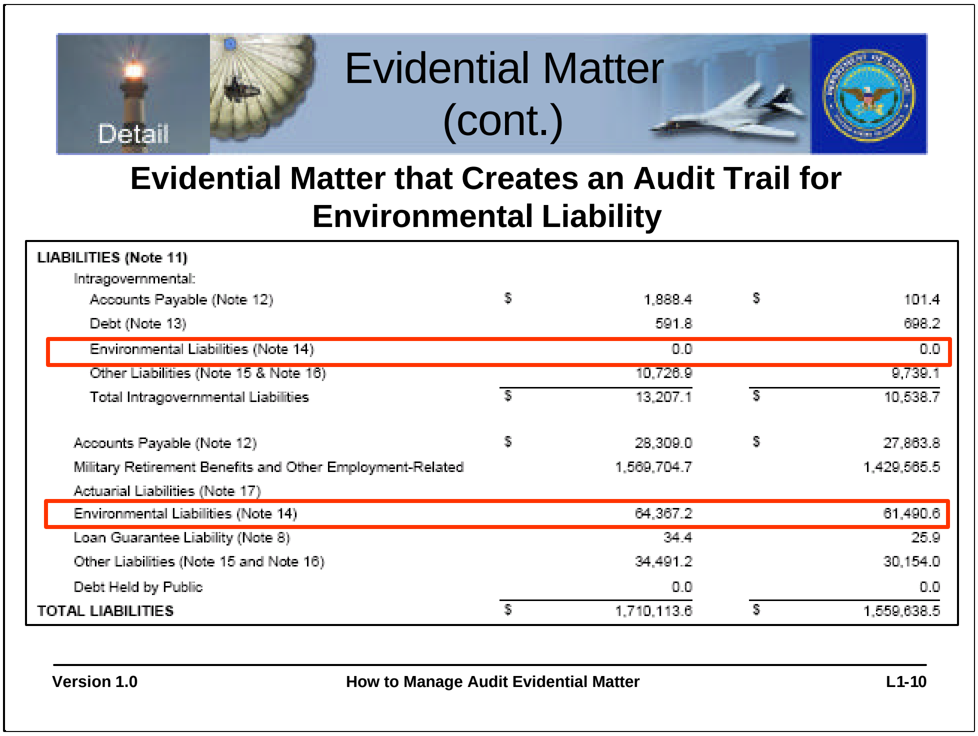
Next, an obligation (with the same document number) is created once the purchase is approved.

After the obligation is recorded, the PP&E is received. Once the PP&E is received, a receiving document is prepared.

The PP&E is capitalized (since it exceeded the DoD financial threshold of $100,00) and depreciated, based on the guidance in the DoDFMR, and then recorded in the appropriate accounting and property accountability system. At the appropriate time a disbursement is made for the transaction.

This illustrates an audit trail. A unique document number is established and can be tracked from its inception to the final disbursement. The PP&E is traceable to the appropriate property accountability system of your entity and the financial information can be tracked.

Let’s look at evidential matter that creates an audit trail for an environmental liability.



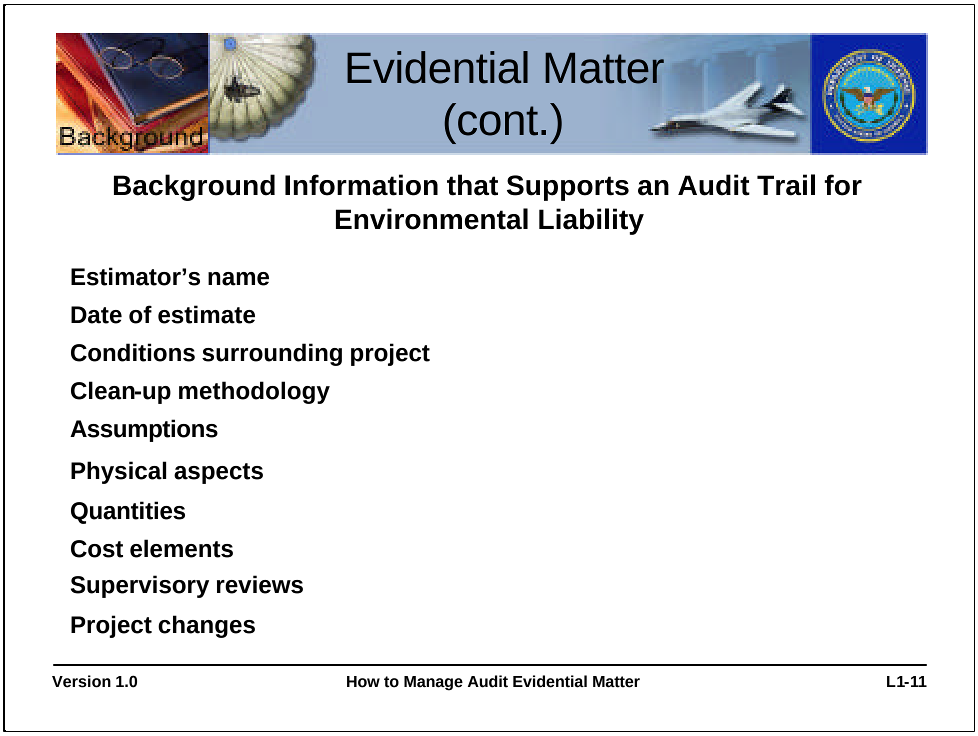
Evidential Matter (cont.)

Evidential Matter that Creates an Audit Trail for Environmental Liability

LIABILITIES (Note 11)				
Intragovernmental:				
Accounts Payable (Note 12)	$	1,888.4	$	101.4
Debt (Note 13)		591.8		698.2
Environmental Liabilities (Note 14)		0.0		0.0
Other Liabilities (Note 15 & Note 16)		10,726.9		9,739.1
Total Intragovernmental Liabilities	$	13,207.1	$	10,538.7
Accounts Payable (Note 12)	$	28,309.0	$	27,863.8
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)		1,569,704.7		1,429,565.5
Environmental Liabilities (Note 14)		64,367.2		61,490.6
Loan Guarantee Liability (Note 8)		34.4		25.9
Other Liabilities (Note 15 and Note 16)		34,491.2		30,154.0
Debt Held by Public		0.0		0.0
TOTAL LIABILITIES	$	1,710,113.6	$	1,559,638.5

Environmental liabilities are reported on the financial statements in conformance with financial management and accounting standards and are subject to audit. The documentation for environmental cost estimates are required to create an audit trail to substantiate the totals on the Balance Sheet.

Additional information about auditing environmental liabilities can be obtained from the course “How to Document and Properly Account for Environmental Liabilities” to be offered in Fall 2005.


Background

Evidential Matter (cont.)

Background Information that Supports an Audit Trail for Environmental Liability

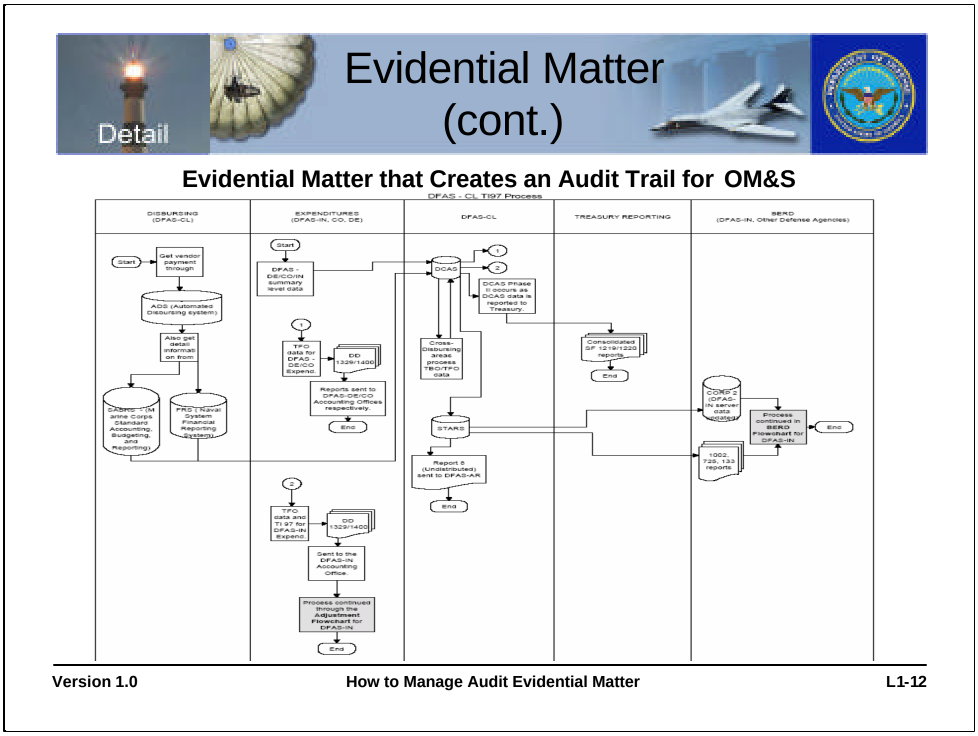
Estimator’s name
Date of estimate
Conditions surrounding project
Clean-up methodology
Assumptions
Physical aspects
Quantities
Cost elements
Supervisory reviews
Project changes

The cost estimate includes summary documents that support the operations and maintenance costs.

Background information includes:

- estimator name
- date the estimate was complete
- other information needed to provide the conditions surrounding the project
- clean-up methodology (steps to complete the project cleanup)
- assumptions (a reasonable estimate of the needed items that are anticipated but actual amounts are unknown at the time the estimate is being completed)
- physical aspects (tangible assets of the project, such as the acres of land and number of monitoring wells associated with the project)
- quantities (amounts needed for a particular physical aspect)
- cost elements (cost to purchase a particular physical aspect, individual costs associated with the cost/estimate, and recognition of the addition or removal of cost when the project is funded)
- supervisory reviews (documented signature and date of the supervisor approving the estimate)
- project changes (justification on any increase or decrease to the project costs that need a written approval).

Let’s look at evidential matter that creates an audit trail for OM&S.



Evidential Matter (cont.)

Evidential Matter that Creates an Audit Trail for OM&S

Detail
DFAS - CL TI97 Process
DISBURSING (DFAS-CL)
EXPENDITURES (DFAS-IN, CO, DE)
DFAS-CL
TREASURY REPORTING
BERD (DFAS-IN, Other Defense Agencies)
Start
Get vendor payment through
ADS (Automated Disbursing system)
Also get detail informati on from
SABRS - (Marine Corps Standard Accounting, Budgeting, and Reporting)
FRS (Naval System Financial Reporting System)
Start
DFAS - DE/CO/IN summary level data
1
TFO data for DFAS - DE/CO Expend.
DD 1329/1400
Reports sent to DFAS-DE/CO Accounting Offices respectively.
End
2
TFO data and TI 97 for DFAS-IN Expend.
DD 1329/1400
Sent to the DFAS-IN Accounting Office.
Process continued through the Adjustment Flowchart for DFAS-IN
End
DCAS
1
2
DCAS Phase II occurs as DCAS data is reported to Treasury.
Cross-Disbursing areas process TBO/TFO data
STARS
Report 8 (Undistributed) sent to DFAS-AR
End
Consolidated SF 1219/1220 reports
End
CORP 2 (DFAS-IN server data updated)
1002, 725, 133 reports
Process continued in BERD Flowchart for DFAS-IN
End

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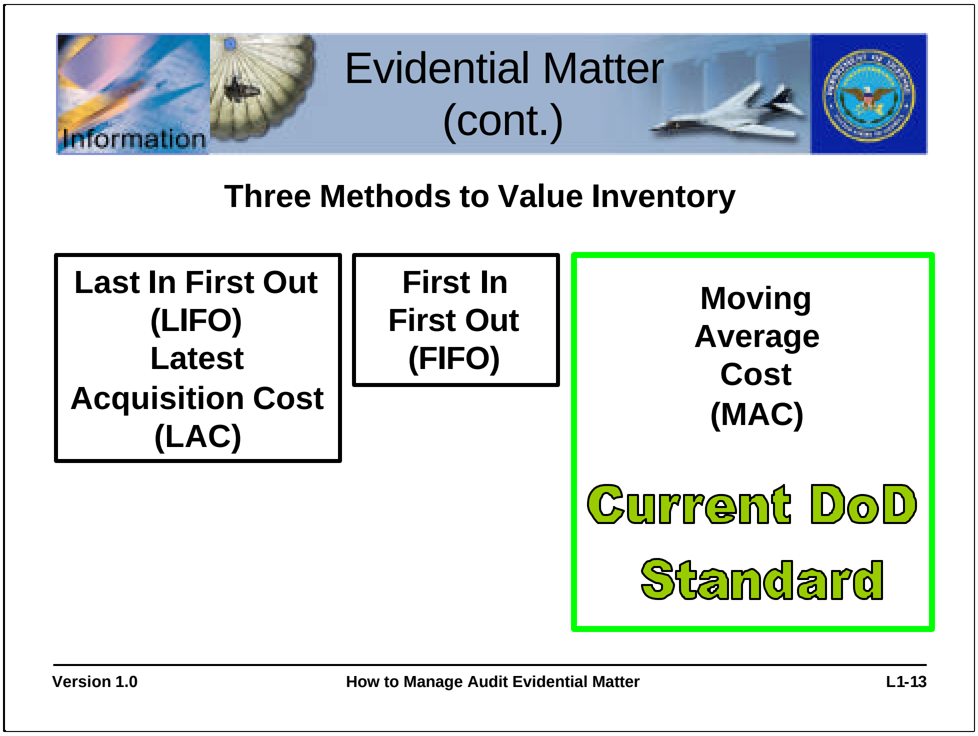
This flowchart shows an example of a Navy systems flow for Treasury Index 97 in the OM&S Federal Inventory, Supplies, and Materials System. This system relies on, and interacts with, other agency-specific systems.

For example, inventory systems may trigger the decision to procure, while the disposition of an inventory end item may be used to establish the agency's property management system record. The principal system that shares information requirements and creates two-way dependencies with the Inventory, Supplies and Materials system is the core financial system. These dependencies help to ensure integrity and control in the areas of budget, program management and delivery, and external reporting.

At every point of acquisition of material, a source document is available to support each of these systems in creating an audit trail. Auditors must understand the process flow to follow evidential matter to test the validity of transactions.

Another important aspect when considering an audit trail is how we value inventory or cost application (Defense Working Capital Fund (DWCF) or vendor cost of goods) which include direct, indirect, and General & Administrative (G&A)).



Evidential Matter (cont.)

Three Methods to Value Inventory

Last In First Out (LIFO) Latest Acquisition Cost (LAC)

First In First Out (FIFO)

Moving Average Cost (MAC)

Current DoD Standard

The methods that the government uses to value inventory affect the cost of goods. The government uses three methods to value inventory:

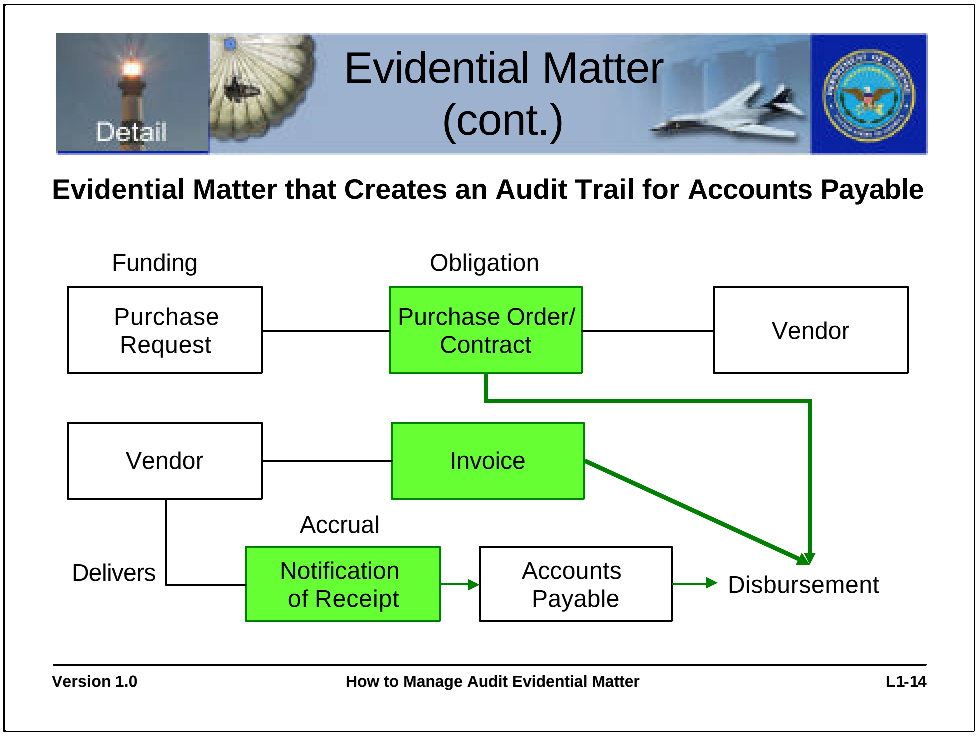
- Last In First Out (LIFO) and Latest Acquisition Cost (LAC)
- First In First Out (FIFO)
- Moving Average Cost (MAC).

The LIFO method of valuing inventory is based on the assumption that the current acquisition costs are incurred to make possible current sales, while maintaining an adequate inventory of goods on hand. Under this method, the latest costs are most closely associated with current revenue, and thus the matching principle of income determination is carried out. The problem is that on the Balance Sheet, inventory under the LIFO tends to be valued at the original cost of accumulating a minimum level of inventory.

The FIFO method of valuing inventory assumes that costs are best valued when the oldest goods are sold before the newer stock. This method conforms to reality and in some cases is necessary when considering that the nature of the product requires a turn-over due to shelf life. This method is systematic and easy to apply. It adheres to cost principles, and the costs assigned to inventory are close to what is being paid for inventory replacement.

The MAC method of valuing inventory is based on the assumption that all goods are commingled and that no batch of goods is retained in the inventory. The inventory is priced on the basis of average prices paid for the goods, weighted according to the quantity purchased at each price. The DoD is in the process of adopting the MAC method of valuing its inventory.

Let’s look at evidential matter that creates an audit trail for Accounts Payable.



Detail

Evidential Matter (cont.)

Evidential Matter that Creates an Audit Trail for Accounts Payable

Funding

Purchase Request

Obligation

Purchase Order/ Contract

Vendor

Vendor

Invoice

Accrual

Delivers

Notification of Receipt

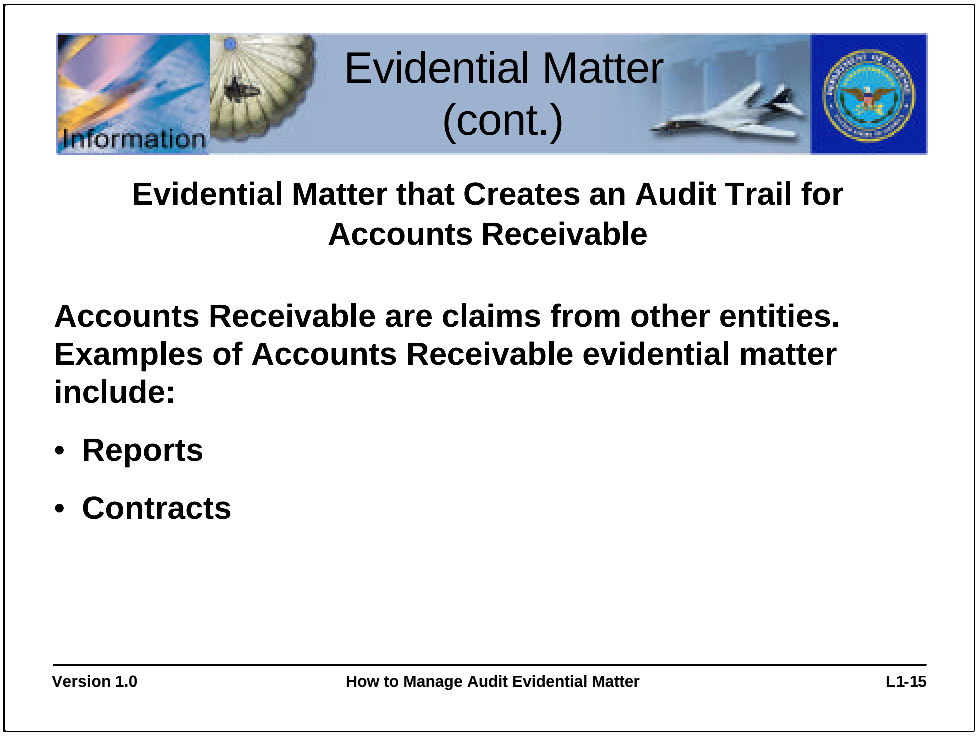
Accounts Payable

Disbursement

Accounts payable are amounts owed by the accounting entity for goods and services received, progress in contract performance, and rents due to other entities. Delivered Orders-Obligations Paid is the budgetary account that matches the proprietary account “Funds Disbursed.” It represents the dollar value of goods and services received for which payment has been made.

The process of recording these transactions and the documented audit trail follow the stages of expenditure accounting. A budget commitment is created after a funded purchase request has been received authorizing a purchase. A purchase order is submitted to the vendor, serving as documentation for the obligation. An Account Payable is created when the item is constructively or actually received as evidenced by a receiving report. Auditors take samples of Accounts Payable to validate the invoice amount to the recorded amount, purchase order/contract amount to validate prices, and receiving report to validate receipt and quantities. This is an indication that there is a valid purchase. Information comes through system interfaces and the supporting documentary evidence is under control at the various locations.

Let’s look at evidential matter that creates an audit trail for Accounts Receivables.


Information

Evidential Matter (cont.)

Evidential Matter that Creates an Audit Trail for Accounts Receivable

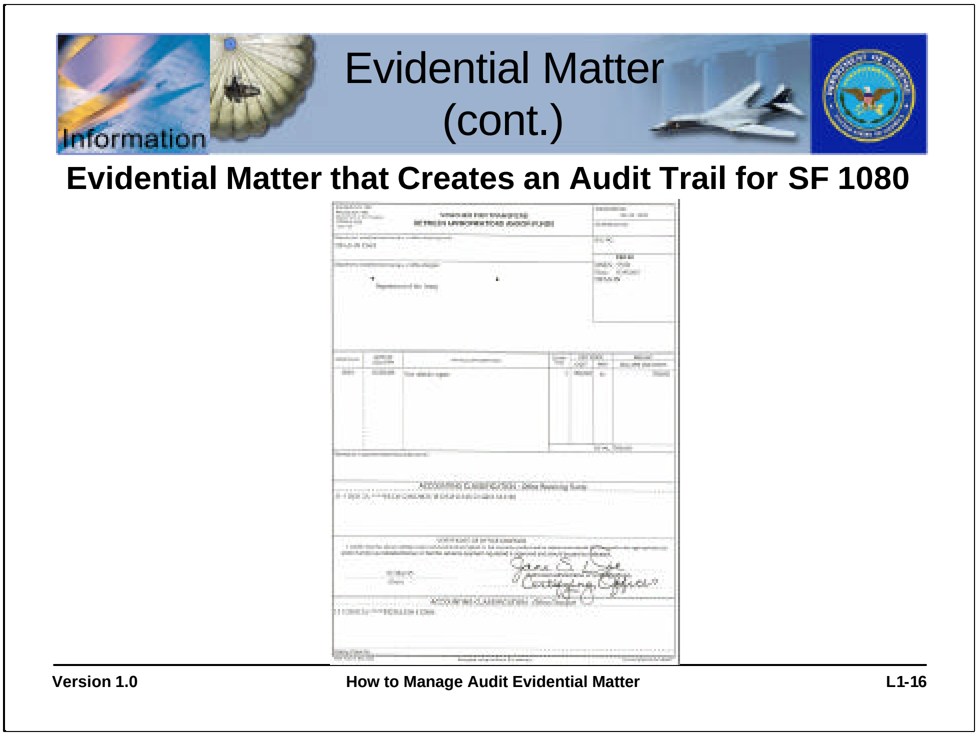
Accounts Receivable are claims from other entities. Examples of Accounts Receivable evidential matter include:

- **Reports**
- **Contracts**

Accounts Receivable can be amounts due the government from other U.S. government organizations or from the public. Accounts receivable from the government are amounts due from U.S. government organizations or funds. Accounts Receivable from the public are all accounts receivable arising from the sale of goods and services and from operations involving other than federal government organizations.

Examples include debts owed by military personnel, civilian employees, and contractors. Gross receivables are reduced to net realizable value by an allowance for doubtful accounts. Auditors may look at a report on aged receivables and determine if management is exercising due diligence in collecting delinquent accounts. Auditors may look at documentation related to the receivables to determine that they are not fraudulent. In the case of overpayments, as a result of the bill being paid twice, use a Standard Form (SF) 1080, Voucher for Transfers Between Appropriations and/or Funds to collect.

Let's look at evidential matter that creates an audit trail for the SF 1080.



Information

Evidential Matter (cont.)

Evidential Matter that Creates an Audit Trail for SF 1080

Version 1.0 How to Manage Audit Evidential Matter L1-16

The SF 1080 is used to record receipts, collections, transfer of funds, and disbursements.

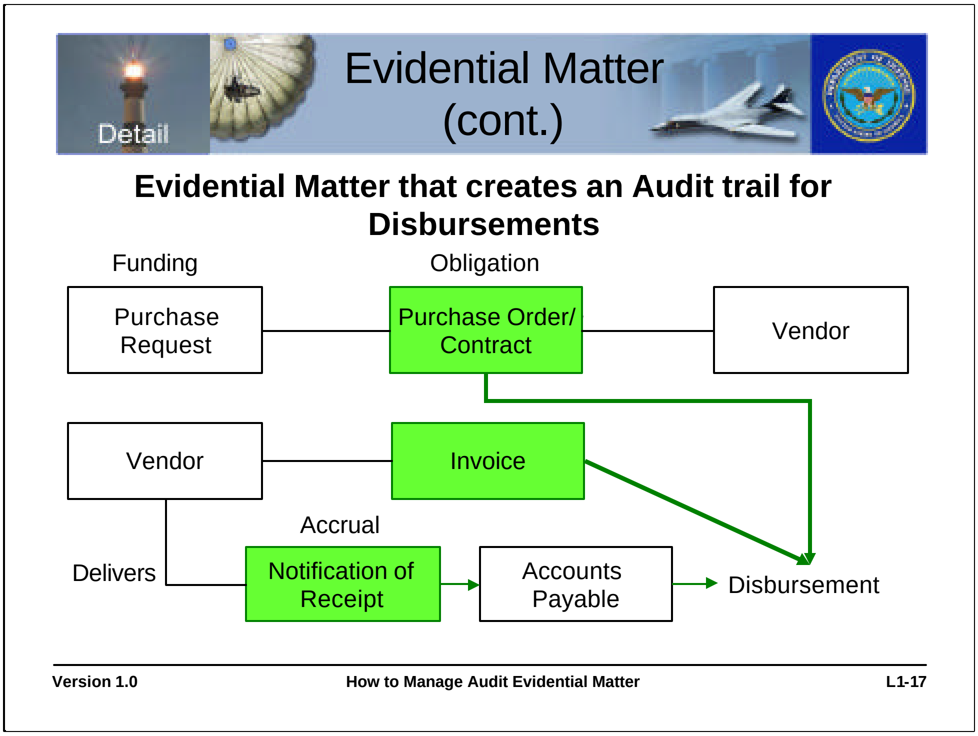
Receipts include non-Interfund bills that require the billed office to pay by check. An original and two copies of the Interfund billing will be provided to the office billed. If an identification or bill number is used, only an original and one copy will be sent by the billing office.

Use SFs 1080 for collections received without an acceptable collection voucher. Used in this capacity, the disbursing officer is contacted for information about the number of copies required and the preparation and distribution of collection vouchers. The collecting officer's signature is not required on the SF 1080, unless the remitter requires a receipt.

SFs 1080 are used to transfer funds between government agencies to bill amounts due for material or services furnished or to request advance payments for materials or services to be furnished. In this case, the supplying government activity initiates the SF 1080 by forwarding it to the receiving activity. The receiving activity provides a certificate for the receipt and acceptance transmittal and then sends the bill to the disbursing officer for payment.

When used as a disbursement document, the SF 1080 is completed to transfer funds from one appropriation or fund to another. This is commonly called no check drawn 1080s, since no check or cash is involved. To be a valid transaction, the SF 1080 must contain a voucher number, the activity's receiving funds office and the one charge, order number, date of delivery, article or services, amount, remittance address, accounting classification for office receiving funds, date, authorized signature of disbursing officer, and accounting classification of the office charged.

Let's look at evidential matter that creates an audit trail for Disbursements.



Detail

Evidential Matter (cont.)

Evidential Matter that creates an Audit trail for Disbursements

Funding

Obligation

Purchase Request

Purchase Order/ Contract

Vendor

Vendor

Invoice

Accrual

Delivers

Notification of Receipt

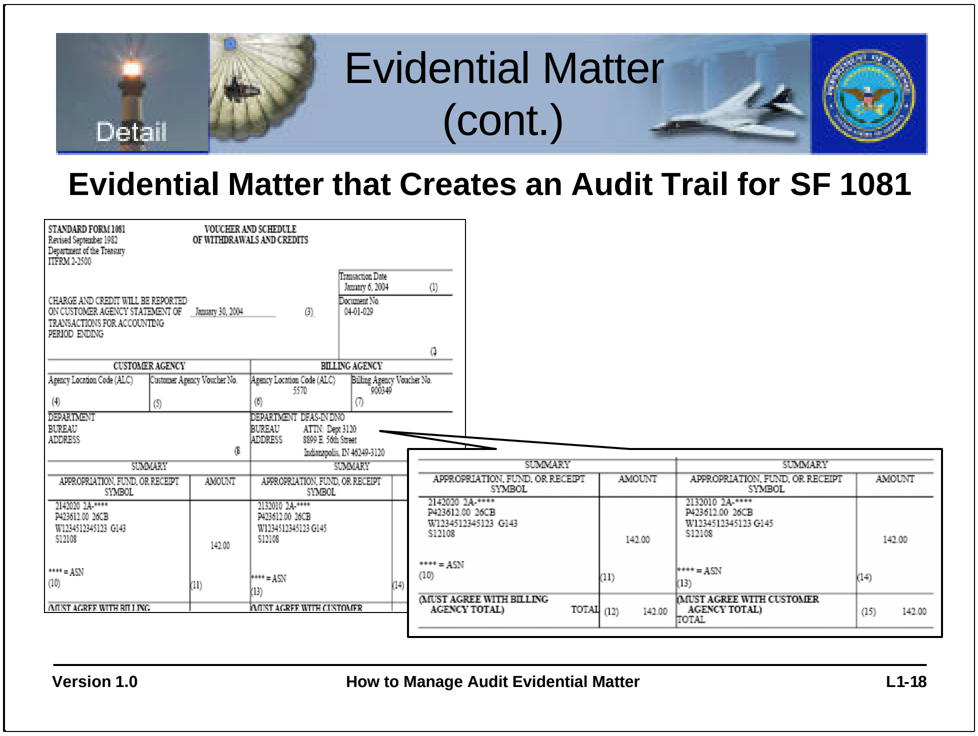
Accounts Payable

Disbursement

Version 1.0 How to Manage Audit Evidential Matter L1-17

Disbursement is the final stage of expenditure accounting. Three documents that are necessary before a payment can be made are the contract, the invoice, and the notification of receipt. Auditors will look at the proprietary data of these documents to be certain that all activities associated with the payments are valid and will perform tests to be certain that payments are being made in accordance will the Prompt Payment Act.

Let’s look at evidential matter that creates an audit trail for the SF 1081, Voucher and Schedule of Withdrawal and Credit.



Detail

Evidential Matter (cont.)

Evidential Matter that Creates an Audit Trail for SF 1081

STANDARD FORM 1081
Revised September 1982
Department of the Treasury
ITFRM 2-2500

VOUCHER AND SCHEDULE
OF WITHDRAWALS AND CREDITS

Transaction Date January 6, 2004 (1)

CHARGE AND CREDIT WILL BE REPORTED ON CUSTOMER AGENCY STATEMENT OF TRANSACTIONS FOR ACCOUNTING PERIOD ENDING January 30, 2004 (3)

Document No. 04-01-029 (2)

CUSTOMER AGENCY		BILLING AGENCY	
Agency Location Code (ALC) (4)	Customer Agency Voucher No. (5)	Agency Location Code (ALC) 5570 (6)	Billing Agency Voucher No. 900349 (7)

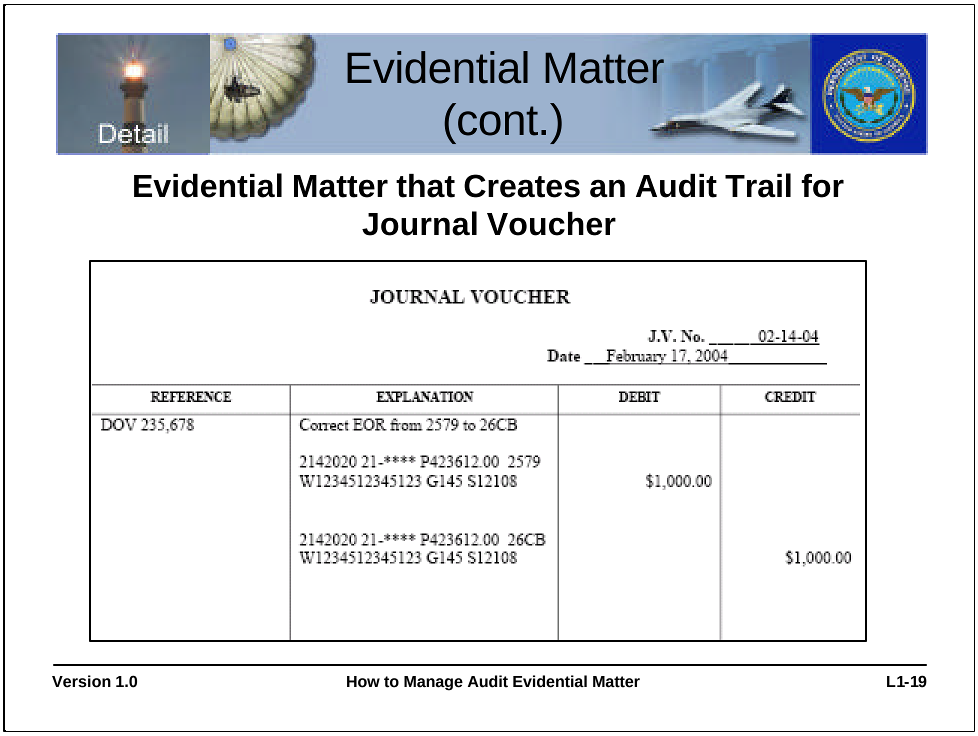
DEPARTMENT BUREAU ADDRESS (8	DEPARTMENT DFAS-IN DNO BUREAU ATTN: Dept 3120 ADDRESS 8899 E. 56th Street Indianapolis, IN 46249-3120

SUMMARY		SUMMARY	
APPROPRIATION, FUND, OR RECEIPT SYMBOL	AMOUNT	APPROPRIATION, FUND, OR RECEIPT SYMBOL	AMOUNT
2142020 2A-**** P423612.00 26CB W1234512345123 G143 S12108 **** = ASN (10)	142.00 (11)	2132010 2A-**** P423612.00 26CB W1234512345123 G145 S12108 **** = ASN (13)	142.00 (14)
(MUST AGREE WITH BILLING AGENCY TOTAL) TOTAL	(12) 142.00	(MUST AGREE WITH CUSTOMER AGENCY TOTAL) TOTAL	(15) 142.00

The SF 1081 is used to record cost transfers or accounting adjustments that require a change to the department code, fiscal year, basic symbol number, limit, amount, and fiscal station number when the expenditure has already been reported to the accountable center. When viewing an SF 1081, you will be able to see the flow of funds from one appropriation to another. All supporting documents must be maintained.

The SF 1081 must be sufficiently documented describing the reason that it is being used. This corroborating information may be in the form of a hard copy or as part of the electronic systems entry.

Let’s look at evidential matter that creates an audit trail for JVs.



Detail

Evidential Matter (cont.)

Evidential Matter that Creates an Audit Trail for Journal Voucher

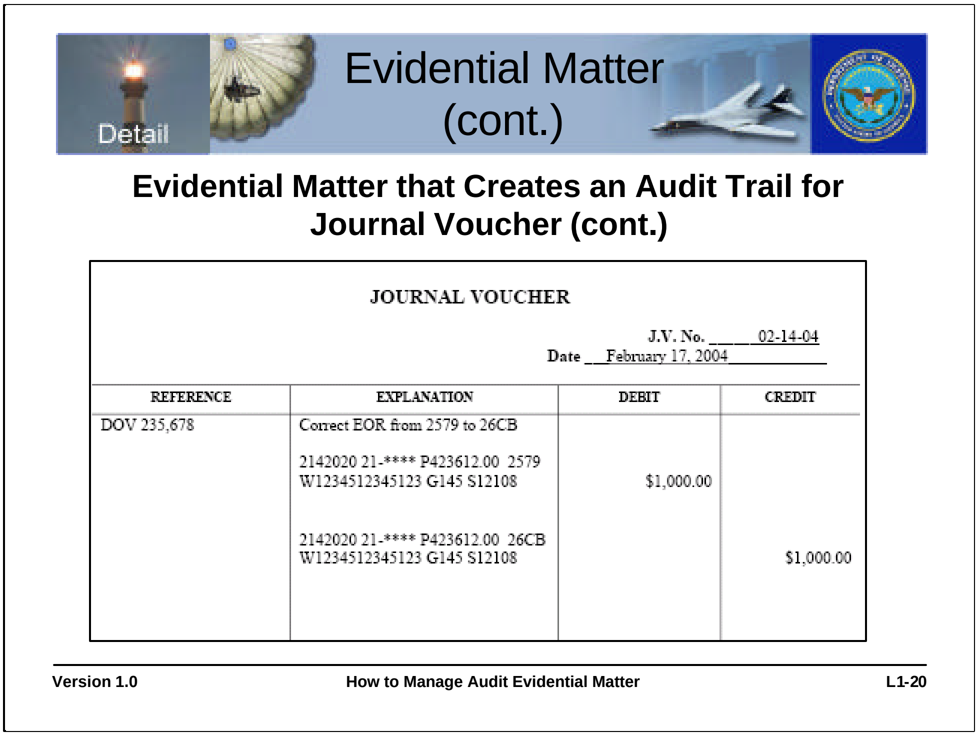
JOURNAL VOUCHER

J.V. No. 02-14-04
Date February 17, 2004

REFERENCE	EXPLANATION	DEBIT	CREDIT
DOV 235,678	Correct EOR from 2579 to 26CB		
	2142020 21-**** P423612.00 2579 W1234512345123 G145 S12108	$1,000.00	
	2142020 21-**** P423612.00 26CB W1234512345123 G145 S12108		$1,000.00

JVs are used for accounting or adjustment entries made to General Fund general ledger accounts. A change in the object class code (referenced as Element of Resource on the slide) would be an example of the usage of a JV. JVs are processed manually or mechanically through the accounting system. Proper preparation of JVs is important to ensure that documentation for detailed audit trails exist and that the JV has accurately recorded a financial event. These entries are processed into the accounting system and must be certified by a approving authority for validity and correctness. DoD uses two primary types of JVs, source entry and correcting.

Source-entry JVs are accounting entries that due to system limitations or timing differences, have not been entered into the system. By nature, a source entry JV is usually summarized at the originator level by standard general ledger accounts. Although transaction detail may not be available, the JV must be supported by documentation for the summarized amounts. Source entry JV are generally used for month-end closing, year-end adjusting and closing purposes, and quarterly unaudited and fiscal year end audited financial statement processing. Source entry JVs also include adjustments for information provided through data calls, such as manual adjustments to funding or property, plant and equipment recognitions.



Detail

Evidential Matter (cont.)

Evidential Matter that Creates an Audit Trail for Journal Voucher (cont.)

JOURNAL VOUCHER

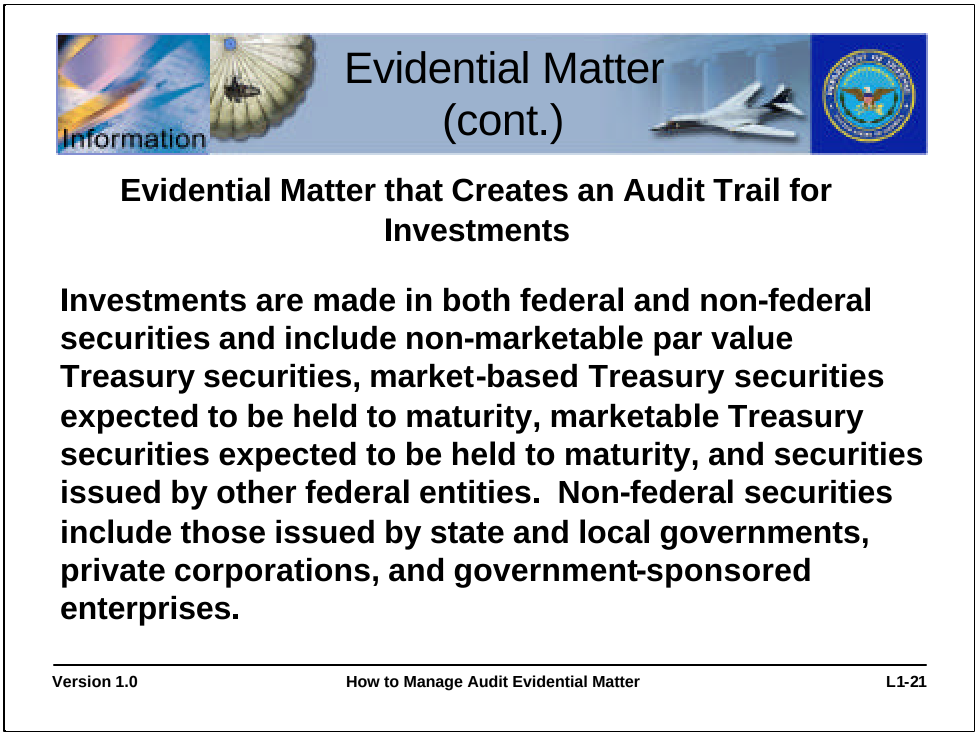
J.V. No. 02-14-04
Date February 17, 2004

REFERENCE	EXPLANATION	DEBIT	CREDIT
DOV 235,678	Correct EOR from 2579 to 26CB		
	2142020 21-**** P423612.00 2579 W1234512345123 G145 S12108	$1,000.00	
	2142020 21-**** P423612.00 26CB W1234512345123 G145 S12108		$1,000.00

Version 1.0 How to Manage Audit Evidential Matter L1-20

Correcting JVs are required to adjust for errors identified during financial report preparation and review process. This type of JV includes specific amounts, accounts and/or transactions related to the correction required. In some cases, correcting are required to adjust errors on previously prepared JVs. In this instance, correcting entries should reverse the effects of incorrect entries and record the correct amount. Both entries can be made on one JV and a single set of supporting documentation. The correcting JV should include a copy of the original JV, documentation supporting the correct amount, and narrative explaining how it is known that the original entry is incorrect. An example of a correcting JVs is when there is a change in the line of accounting other than the department code, fiscal year, basic symbol number, limit, amount, and fiscal station number. A note must be appended with a complete explanation of the circumstances surrounding the JV entry. JVs should not be used without justification.

As an example, the U.S. Department of Agriculture (USDA) Forest Service's Financial Statements for Fiscal Year 2002 and 2003 were cited for a material weakness regarding the excessive use of adjusting JVs. Due to human error and a lack of understanding, incorrectly posted adjusted JVs resulted in significant misstatements to the General Ledger (GL). The adjustments corrected general ledger accounts with abnormal balances, previously posted erroneous adjustment JVs, GL posting inaccuracies, and financial information system-generated errors. These entries contributed to a delay in the completion of the audit. The auditing firm recommended that the U.S. Forest Service provide GL training to selected employees and appoint them to be resident GL experts responsible for preparing, reviewing, and approving JVs. It was recommended that the Forest Service also modify the JV form to specifically identify management personnel responsible for reviewing certain aspects of the JVs, identify those business processes that are causing irregularities in the GL, develop an expedited corrective action plan to resolve and correct deficiencies identified, and limit the use of adjusted JVs to only those accounting situations that require their use.


Information

Evidential Matter (cont.)

Evidential Matter that Creates an Audit Trail for Investments

Investments are made in both federal and non-federal securities and include non-marketable par value Treasury securities, market-based Treasury securities expected to be held to maturity, marketable Treasury securities expected to be held to maturity, and securities issued by other federal entities. Non-federal securities include those issued by state and local governments, private corporations, and government-sponsored enterprises.

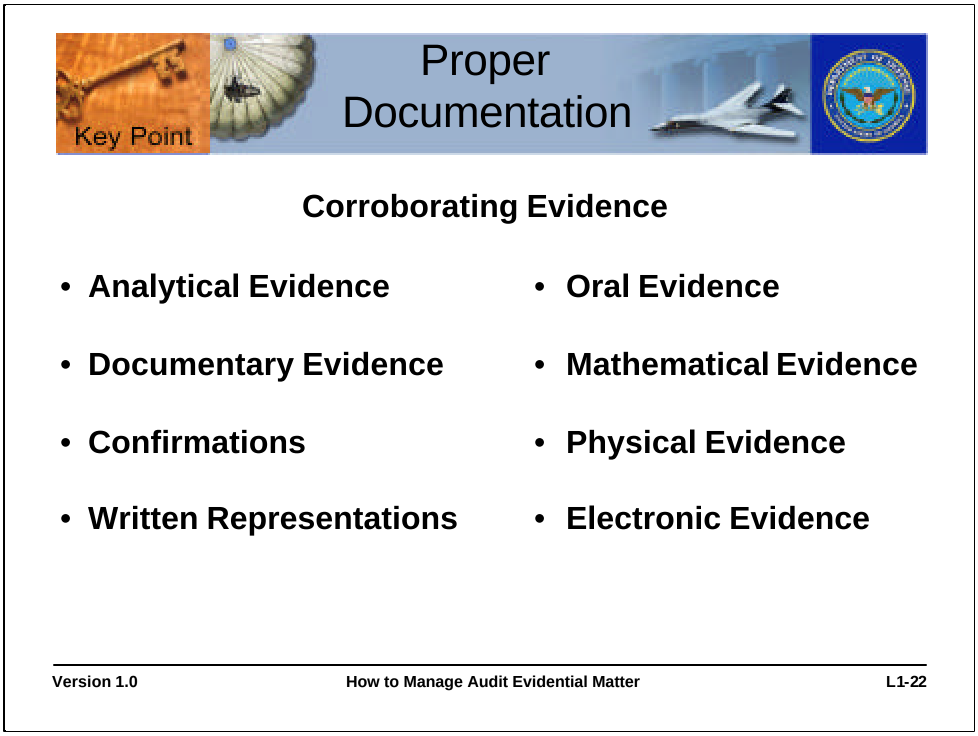
Investments are reported in Note 4 of the financial statements as being intragovernmental or other and are listed as assets on the Balance Sheet. Intragovernmental securities are non-marketable par value Treasury securities issued by the Bureau of the Public Debt to Federal Accounts and are purchased and redeemed at par value exclusively through the Treasury's financing and funding branch. Non-marketable market-based Treasury securities are not traded on any security exchange, but mirror the prices of marketable securities with similar terms.

The GAO/PCIE Financial Audit Manual, Part II, Checklist for Federal Accounting, Reporting, and Disclosures, Page 1050-19, contains 10 questions that provide you with the areas of evidential matter that will serve as a bases for the auditor's opinion. Let's look at one of those questions.

"Are investments in federal securities initially recorded and reported at their acquisition cost or amortized acquisition cost (less an allowance for losses, if any)?"

The question references SFFAS 1, par. 68 and 69, OMB, Bulletin 01-09, Page 20, Section 3.3. This question serves as an example of the accounting treatment to security investments.

Now that you have looked at the flow of evidential matter from the beginning to the end of various audit trails, let's look at how proper documentation impacts the audit trail.



Proper Documentation

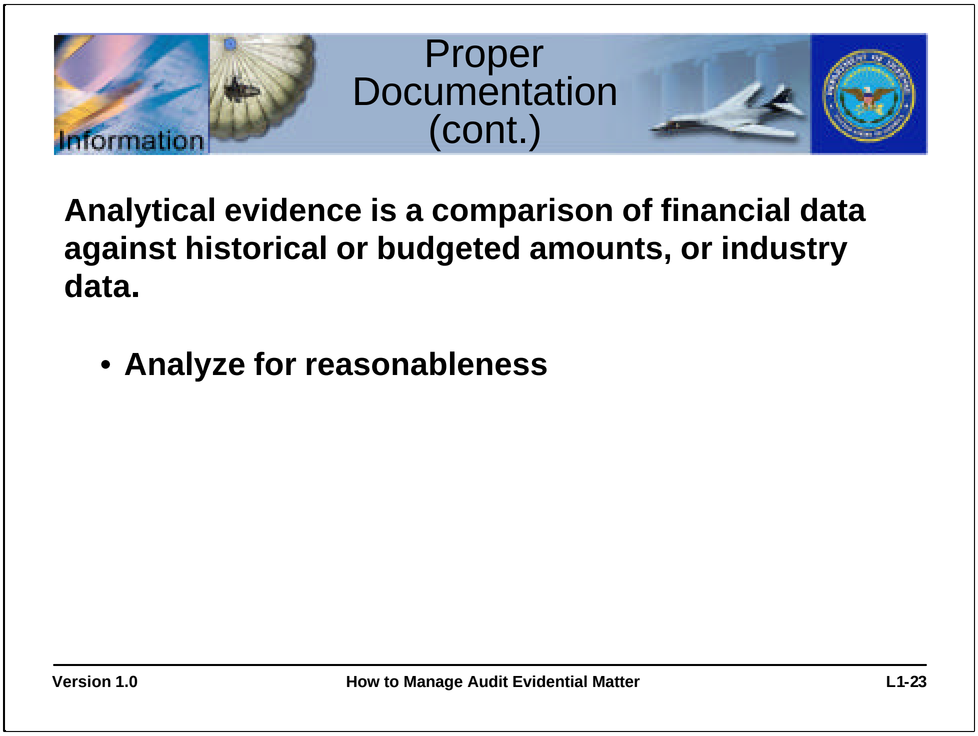
Corroborating Evidence

- Analytical Evidence
- Documentary Evidence
- Confirmations
- Written Representations
- Oral Evidence
- Mathematical Evidence
- Physical Evidence
- Electronic Evidence

Corroborating information is used to form the audit trail to substantiate the underlying accounting data. Remember, the underlying accounting data are the books of original entry, general and subsidiary ledgers, related accounting manuals, and informal or memorandum records, such as work sheets, computations, and reconciliations.

Let's discuss each of these types of corroborating information in more detail as this is the data that creates the audit trail. The corroborating information includes analytical evidence, documentary evidence, confirmations, written representations, mathematical evidence, oral evidence, physical evidence, and electronic evidence. The reliability of this data is important because it will have a direct impact on the auditor's confidence level with respect to your financial statements.

Let's talk about analytical evidence.


Information

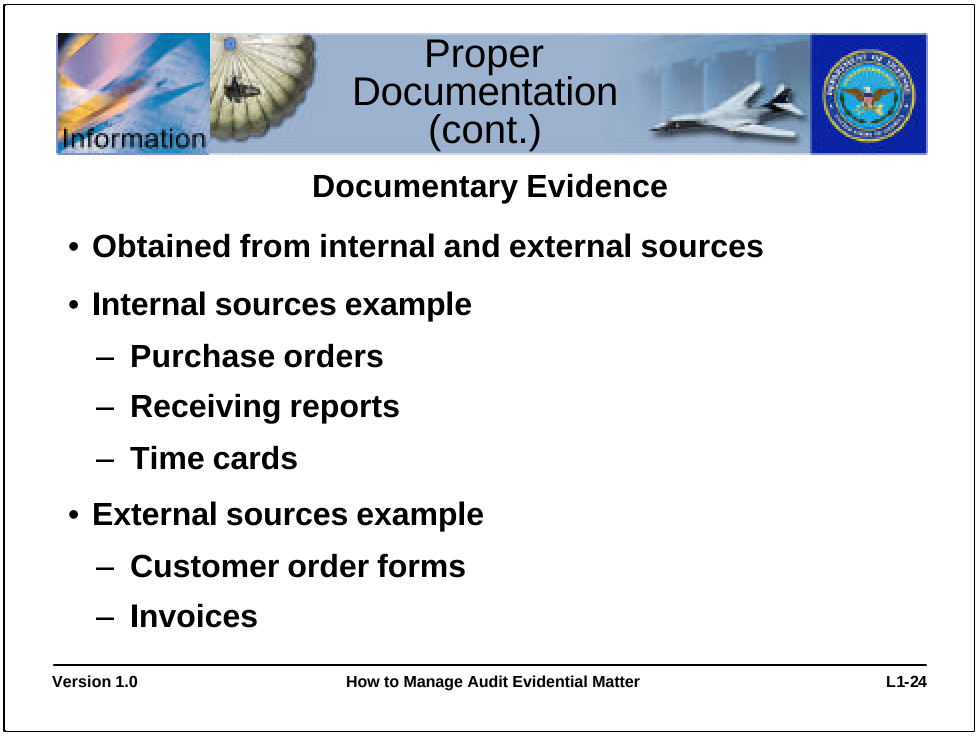
Proper Documentation (cont.)

Analytical evidence is a comparison of financial data against historical or budgeted amounts, or industry data.

- **Analyze for reasonableness**

Analytical evidence involves a comparison of current financial data against historical or budgeted amounts, or industry data. Analyzed for reasonableness, this data is dependent on comparable data. If there is no significant change in the nature and size of your organization, your customer base, and the state of the industry, then you or the auditors could expect that your existing financial data will mirror historical patterns.

Let’s move on to documentary evidence.


Information

Proper Documentation (cont.)

Documentary Evidence

- Obtained from internal and external sources
- Internal sources example
  - Purchase orders
  - Receiving reports
  - Time cards
- External sources example
  - Customer order forms
  - Invoices

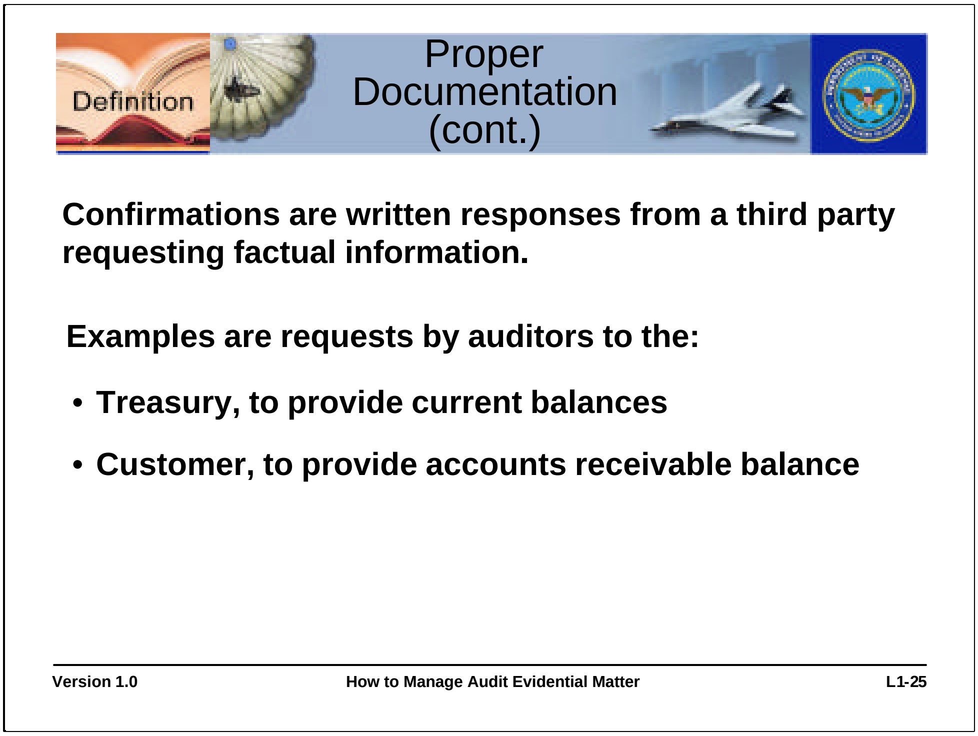
Documentary evidence is obtained from a variety of internal and external sources, and must be available to the auditors upon request.

Examples of internally generated documents include purchase orders, receiving reports, and time cards.

Examples of external documents include customer order forms and supplier invoices.

Since internally generated documents could be created to support fictitious transactions, the reliability could be enhanced if there was evidence circulated to external parties. An example is a shipping document prepared by the buyer that has been signed and stamped by the shipping company.

Let’s discuss confirmations.



Definition

Proper Documentation (cont.)

Confirmations are written responses from a third party requesting factual information.

Examples are requests by auditors to the:

- **Treasury, to provide current balances**
- **Customer, to provide accounts receivable balance**

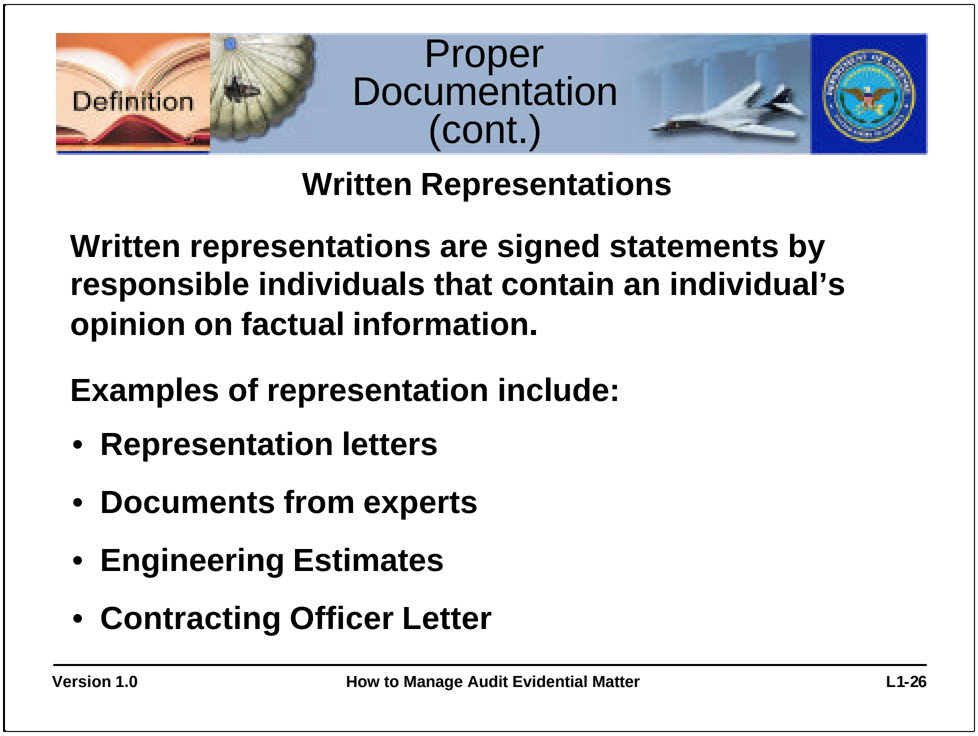
Confirmations constitute documentary evidence that is obtained from written responses from third parties to specific requests for factual information.

Examples of these include:

- inquiries directed to the Treasury to provide cash balances
- inquires directed to individual customers to provide Accounts Receivable balances.

Auditing standards require the auditors to obtain confirmations on Accounts Receivable when possible. Independent party balance inquiries by auditors are a standard practice. These types of inquiries have a high degree of reliability and are used as evidence to support all levels of assertion. It is one of the objectives of accounting to balance the accounting records and Fund Balance with Treasury.

Now let’s talk about at written representations.



Definition

Proper Documentation (cont.)

Written Representations

Written representations are signed statements by responsible individuals that contain an individual's opinion on factual information.

Examples of representation include:

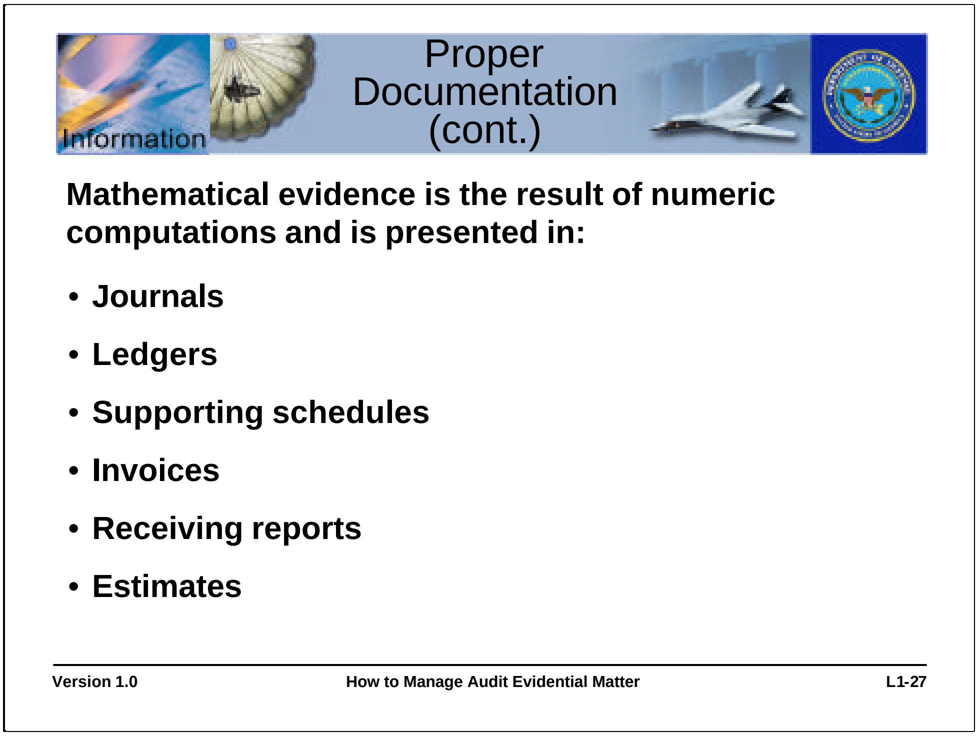
- **Representation letters**
- **Documents from experts**
- **Engineering Estimates**
- **Contracting Officer Letter**

Version 1.0 How to Manage Audit Evidential Matter L1-26

Written representations are signed statements by responsible individuals. These are different from confirmations in that they originate from the client organization and contain an individual's opinion about a matter rather than factual information.

A common form of a written representation is a representation letter, often used to record management replies to auditors inquiries. This documentation often reveals information that is not present in the accounting records. The reliability of this documentation rests on the auditors' ability to corroborate the claims made in the representation letter. Auditors may also need to obtain written responses from an outside expert on areas where the auditors does not have specific knowledge. A written response from the expert documents a competent answer. An example of this is information on litigation validated by an external attorney upon request by the auditor. This type of corroborating information is regarded to have a high degree of reliability.

Let's look at mathematical evidence.


Information

Proper Documentation (cont.)

Mathematical evidence is the result of numeric computations and is presented in:

- **Journals**
- **Ledgers**
- **Supporting schedules**
- **Invoices**
- **Receiving reports**
- **Estimates**

Version 1.0 How to Manage Audit Evidential Matter L1-27

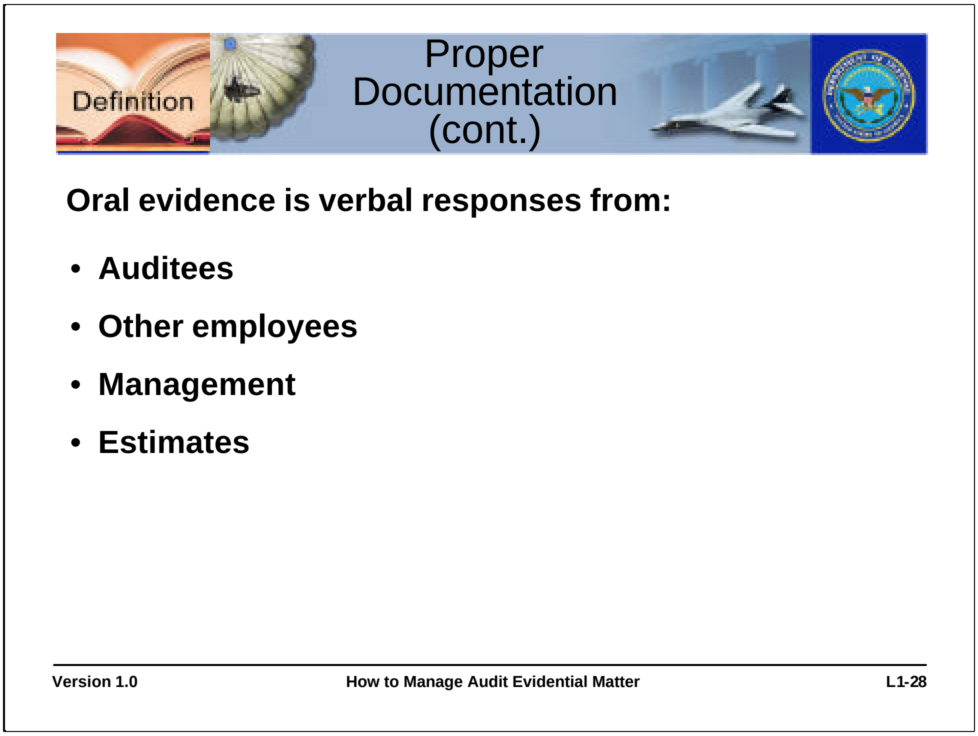
Mathematical evidence is the result of testing information that has been presented by your organization.

This evidence is presented in:

- journals
- ledgers
- supporting schedules
- invoices
- receiving reports
- estimates.

The evidence is often recalculated by auditors to determine reasonableness.

Let’s look at oral evidence.


Definition

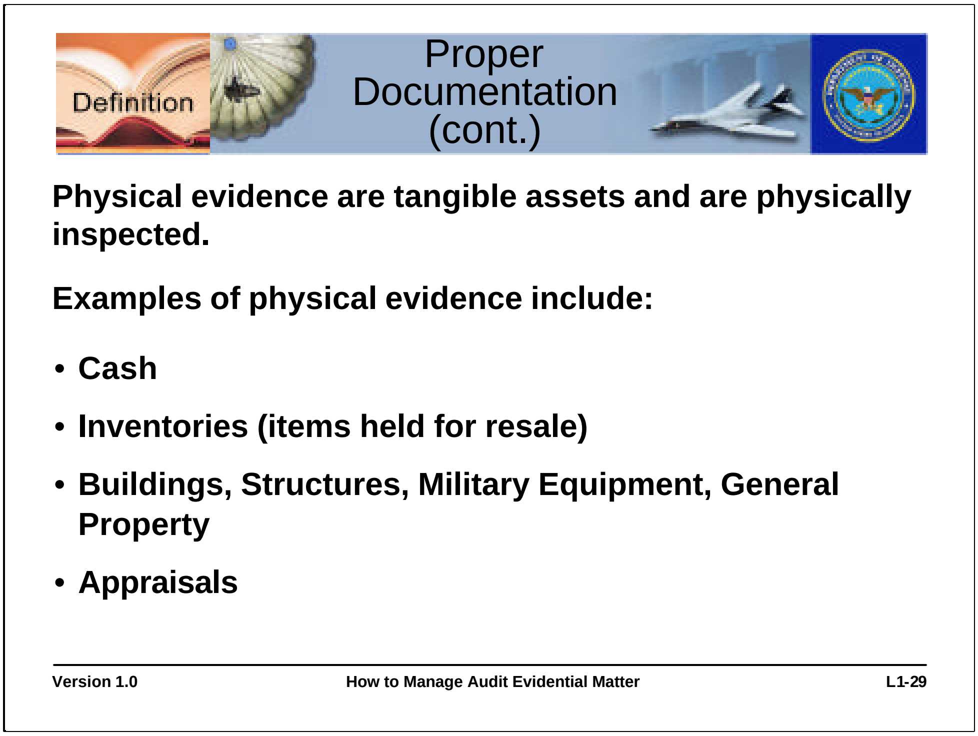
Proper Documentation (cont.)

Oral evidence is verbal responses from:

- **Auditees**
- **Other employees**
- **Management**
- **Estimates**

Oral evidence is verbal evidence that the auditors receive from you, other employees of your organization, and management. This evidence is not considered as reliable and is corroborated by other means. Its value lies in the fact that it may provide direction to the auditors on matters that require further investigation.

Let’s examine physical evidence.


Definition

Proper Documentation (cont.)

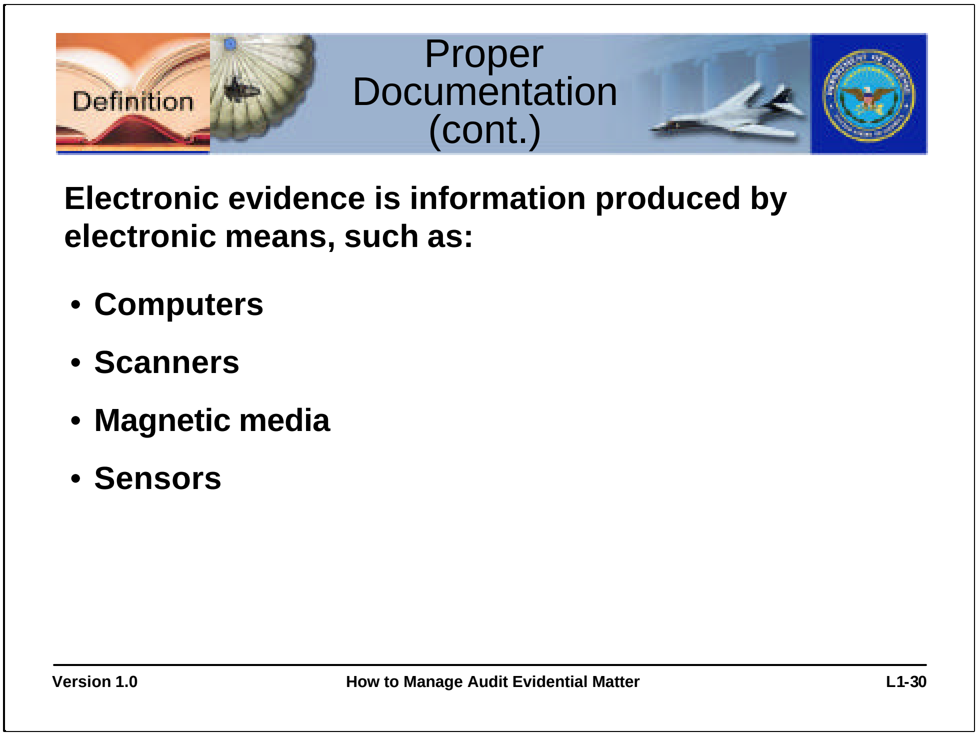
Physical evidence are tangible assets and are physically inspected.

Examples of physical evidence include:

- **Cash**
- **Inventories (items held for resale)**
- **Buildings, Structures, Military Equipment, General Property**
- **Appraisals**

Physical evidence is obtained by the auditors from a physical inspection of tangible assets such as cash, inventories (items held for sale), buildings, structures, Military equipment, general property, and appraisals. The auditors may have to determine the value of plant and equipment, which may require expertise and written documentation from an outside appraiser. Auditors test physical assets to evaluate completeness and existence of information on financial statements.

Let’s look at electronic evidence.


Definition

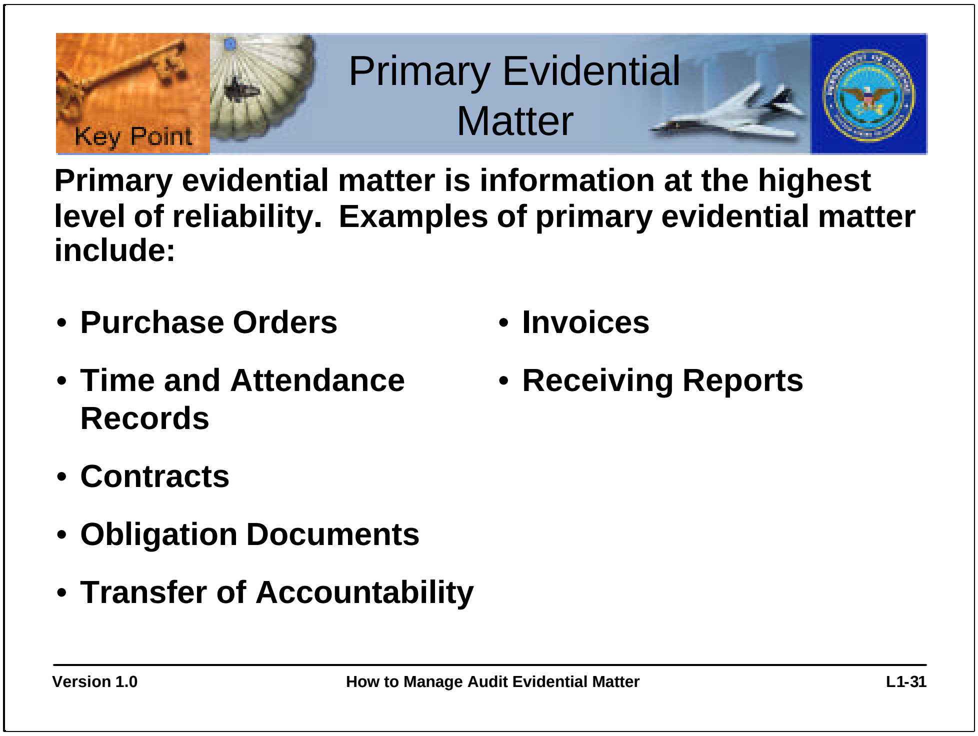
Proper Documentation (cont.)

Electronic evidence is information produced by electronic means, such as:

- **Computers**
- **Scanners**
- **Magnetic media**
- **Sensors**

Electronic evidence is any information produced or maintained by electronic means. This is information that is received through computers, scanners, sensors, and magnetic media. This area has created new challenges for the auditors and the accounting community. The auditors must assess the internal control that is in place for electronic media to be certain of the reliability of electronic media.

Let's look at the reliability of the evidential matter that was the basis for these tests.



Primary Evidential Matter

Primary evidential matter is information at the highest level of reliability. Examples of primary evidential matter include:

- **Purchase Orders**
- **Time and Attendance Records**
- **Contracts**
- **Obligation Documents**
- **Transfer of Accountability**
- **Invoices**
- **Receiving Reports**

Version 1.0 How to Manage Audit Evidential Matter L1-31

Evidential matter is categorized as primary, secondary, or third-party.

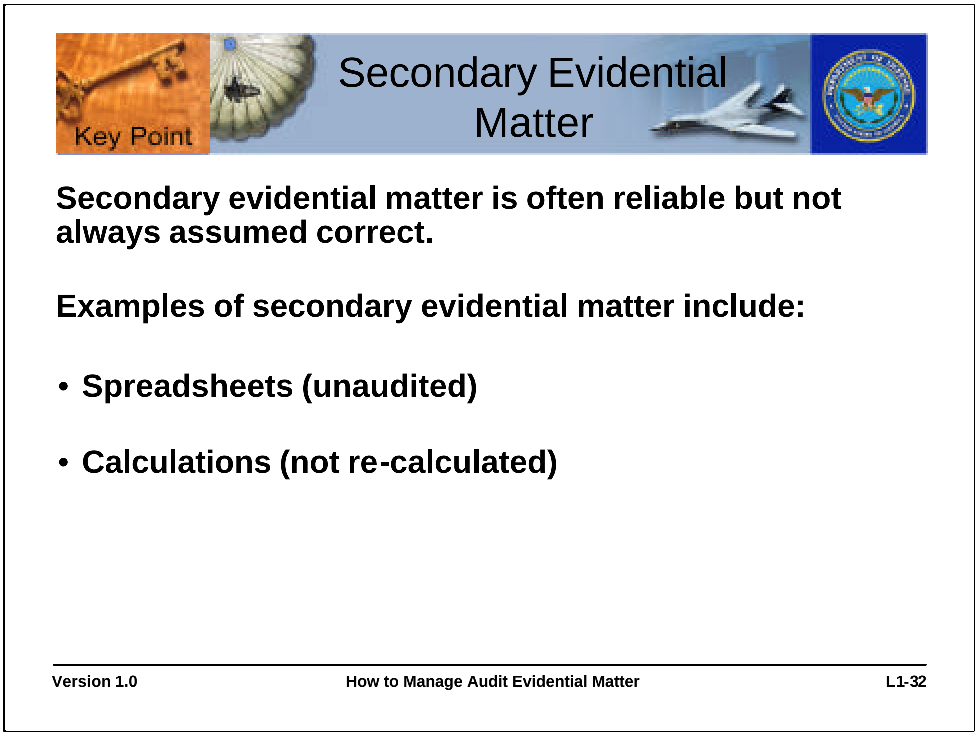
Primary evidential matter is information that is at the highest level of reliability or most reliable. It is considered true as long as contrary evidence is not detected.

Source documents are considered primary evidential matter as long as they:

- were obtained from a credible source
- were developed under an effective system of management controls
- are supported by original documents.

Examples of primary evidence include purchase orders, time and attendance records, contracts, obligation documents, transfers of accountability, invoices, and receiving reports.

Let's take a look at secondary evidential matter.



Secondary Evidential Matter

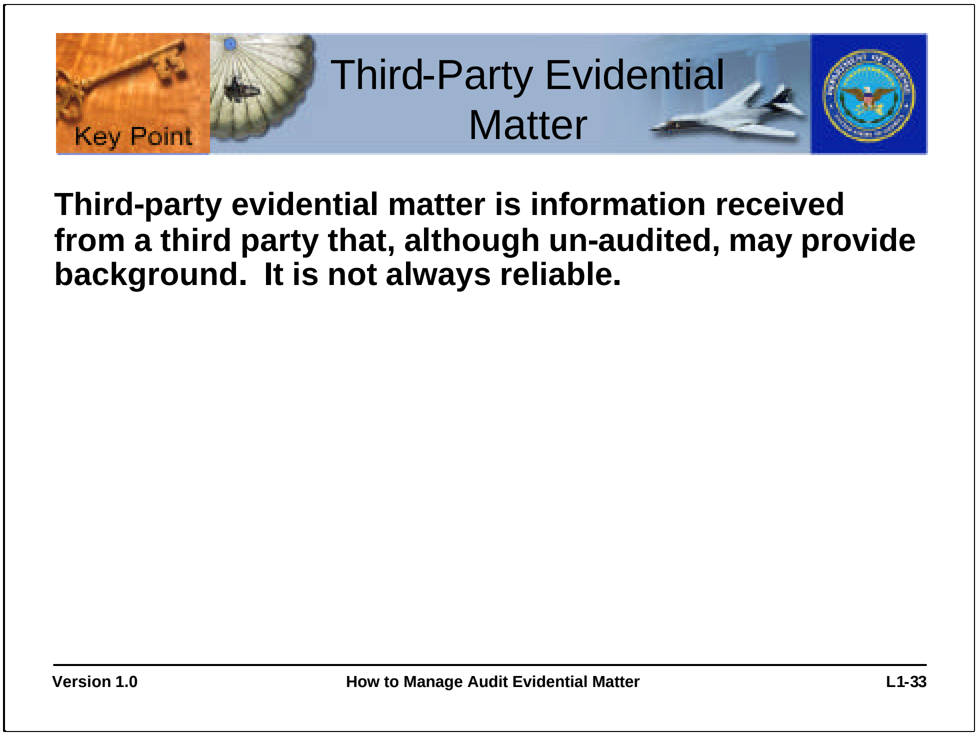
Secondary evidential matter is often reliable but not always assumed correct.

Examples of secondary evidential matter include:

- **Spreadsheets (unaudited)**
- **Calculations (not re-calculated)**

By definition, secondary evidential matter is that evidence that in some way supports primary evidence. Secondary evidential matter is often reliable, but shouldn’t always be assumed correct. Secondary evidence is subordinate to the primary evidence.

Let’s look at third-party evidential matter.



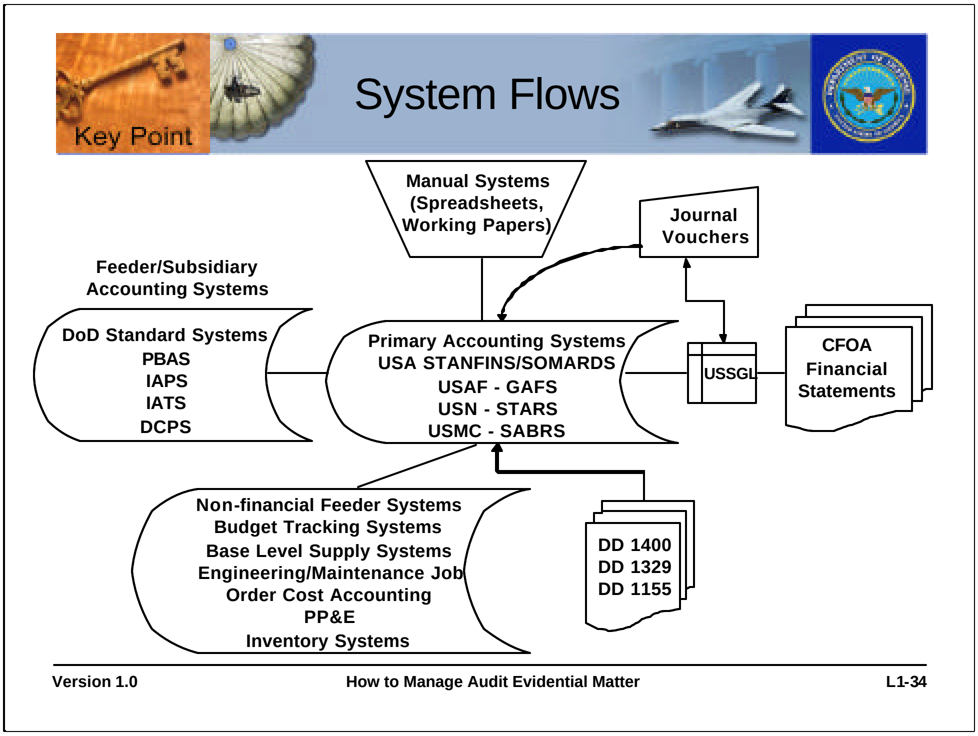
Third-Party Evidential Matter

Third-party evidential matter is information received from a third party that, although un-audited, may provide background. It is not always reliable.

Version 1.0 How to Manage Audit Evidential Matter L1-33

Third-party evidential matter is data gathered from third parties. In some cases, this data has been audited by others, or the auditors have been able to audit the data themselves. In other cases, however, it is not practical to obtain evidence of the data's validity and reliability. How the use of un-audited third-party data affects the auditors' report depends on the data's significance to the auditors' findings. For example, in some circumstances, auditors use un-audited data to provide background information; however, the use of such un-audited data is not appropriate to support audit findings and conclusions.

Let's see how the types of evidential matter relate to a system flow example.



Key Point

System Flows

Manual Systems
(Spreadsheets,
Working Papers)

Journal
Vouchers

**Feeder/Subsidiary
Accounting Systems**

DoD Standard Systems
PBAS
IAPS
IATS
DCPS

Primary Accounting Systems
USA STANFINS/SOMARDS
USAF - GAFS
USN - STARS
USMC - SABRS

USSGL

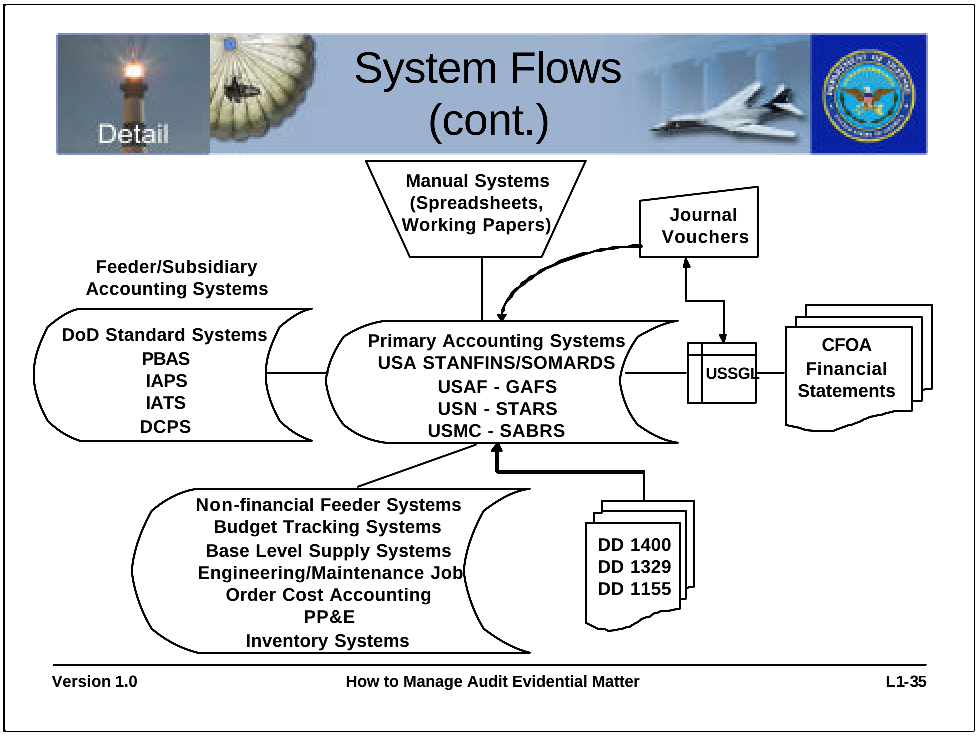
CFOA
Financial
Statements

Non-financial Feeder Systems
Budget Tracking Systems
Base Level Supply Systems
Engineering/Maintenance Job
Order Cost Accounting
PP&E
Inventory Systems

DD 1400
DD 1329
DD 1155

In this system flow, primary accounting systems such as Standard Finance System (STANFINS), Standard Operation and Maintenance, Army Research and Development System (SOMARDS), General Accounting Finance System (GAFS), Standard Accounting and Reporting System (STARS), and Standard Accounting, Budgeting, and Reporting System (SABRS) support the posting of data to the USSGL. The data generated by the primary accounting system is received from feeder or subsidiary accounting systems, non-financial systems, manual spreadsheets and working papers, and JVs. Additional subsidiary data is received from the DD Form 1400, Statement of Interfund Transactions; DD Form 1329, Statement of Transaction; and DD Form 1155, Order for Supplies or Services.

Let's look at individual feeder or subsidiary systems shown on this slide and see the kind of subsidiary data that they provide to the primary accounting systems. The Program Budget Accounting System (PBAS) provides funding distribution data that is generated by the DoD, Military Departments, Defense agencies, and installations/activities after Congress appropriates and authorizes funds. The Integrated Accounts Payable System (IAPS) generates vendor payment information according to the Prompt Payment Act. The Integrated Automated Travel System (IATS) generates Temporary Duty (TDY) and Permanent Change of Station (PCS) travel payment information after it applies the policies and procedures of the Joint Federal Travel Regulations (JFTRs) to travel vouchers submitted by military and civil service personnel. The Defense Civilian Personnel System (DCPS) processes financial information with respect to civilian payroll.



Detail

System Flows (cont.)

Manual Systems (Spreadsheets, Working Papers)

Journal Vouchers

Feeder/Subsidiary Accounting Systems

DoD Standard Systems
PBAS
IAPS
IATS
DCPS

Primary Accounting Systems
USA STANFINS/SOMARDS
USAF - GAFS
USN - STARS
USMC - SABRS

USSGL

CFOA Financial Statements

Non-financial Feeder Systems
Budget Tracking Systems
Base Level Supply Systems
Engineering/Maintenance Job Order Cost Accounting
PP&E
Inventory Systems

DD 1400
DD 1329
DD 1155

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Non-financial feeder systems similarly provide data to the primary accounting systems in the areas of budget tracking, supply levels, engineering/ maintenance job order cost accounting, PP&E, and inventory systems.

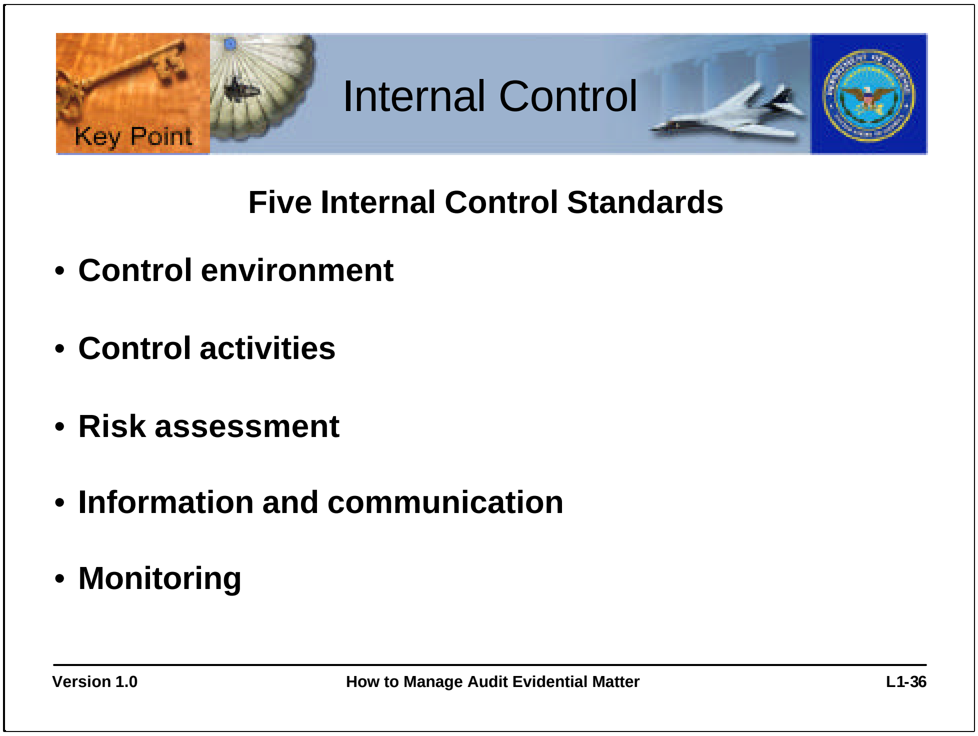
DD Forms 1400, 1329, and 1155 provide subsidiary data to the primary accounting system in the areas of Interfund transactions, statements of transaction, and orders for supplies or services, respectively.

JVs provide adjustment data to the primary accounting systems, while other subsidiary data must be generated and compiled on manual spreadsheets.

The subsidiary systems, financial or non-financial, provide the detail or subsidiary data for postings to the USSGL. The USSGL provides the basis for the CFO financial statements and reporting.

The auditors perform substantive testing on the financial statements and reporting to determine their reliability. If the auditors feel confident of their reliability, that forms the basis of their opinion.

Let’s look at internal control.



Key Point

Internal Control

Five Internal Control Standards

- **Control environment**
- **Control activities**
- **Risk assessment**
- **Information and communication**
- **Monitoring**

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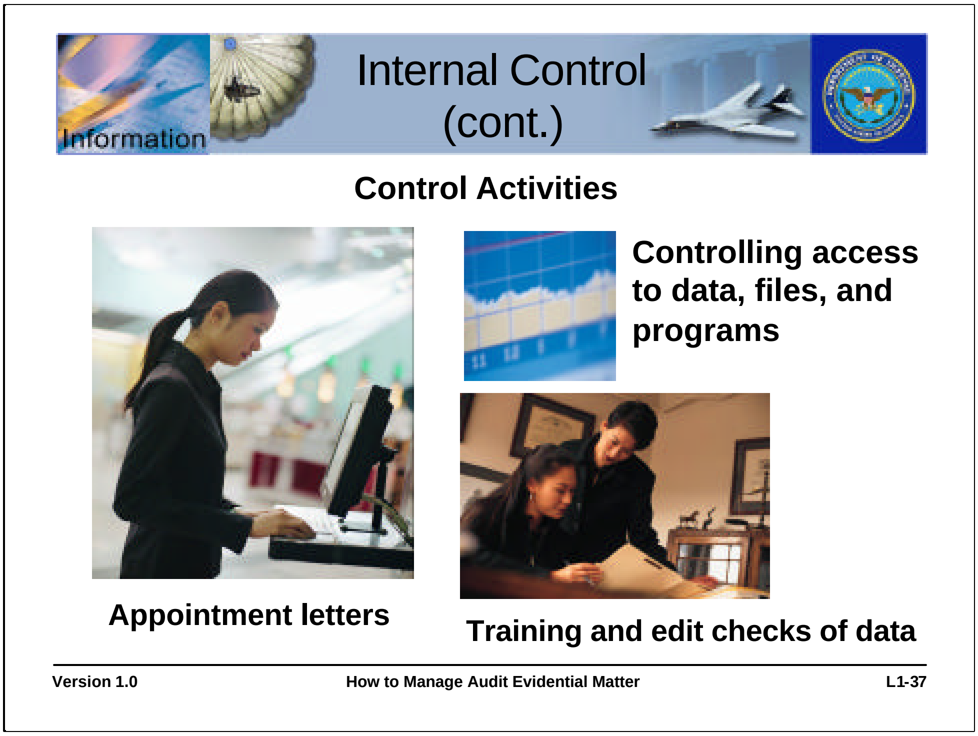
Internal control is a built-in organizational component and included in plans, methods, and procedures to safeguard assets and prevent and detect errors and fraud. Without internal controls, the accomplishment of organizational mission, goals, and objectives is impaired. It is important that you understand that internal controls provide reasonable assurance, not absolute assurance, against errors and fraud. You must work with others and remain vigilant in observing areas of weakness.

There are five internal control standards:

- Control environment
- Control activities
- Risk assessment
- Information and communication
- Monitoring.

The purpose of these standards is to define the minimum level of quality acceptable in government and to provide an evaluation tool for internal control.

Let's talk about the impact of control activities, performance measures, and separation of duties.



Information

Internal Control (cont.)

Control Activities

Controlling access to data, files, and programs

Appointment letters

Training and edit checks of data

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Control activities are internal activities that help ensure that management directives are carried out. They can be effective in accomplishing the agency's control objectives to ensure that actions are taken to address risks. Here are some examples of control activities.

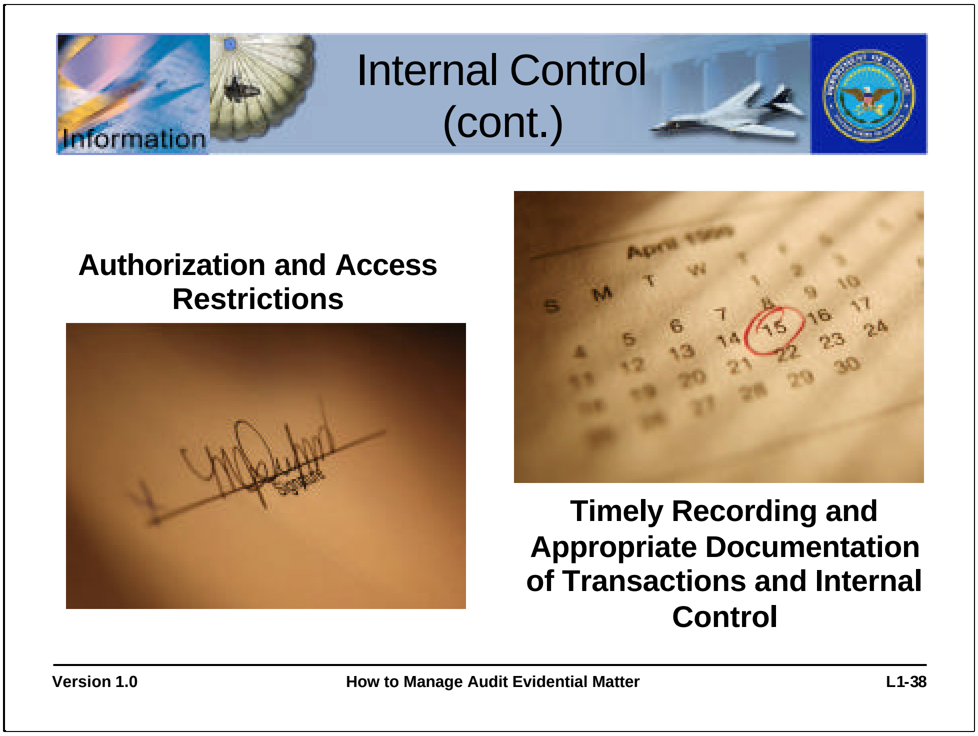
Controls over information processing include examples such as:

- training
- edit checks of data
- appointment letters
- controlling access to data, files, and programs.

Establishment and review of performance measures and indicators allows for a comparison and assessment of different sets of data so that analyses of the relationship can be made and based on the results an appropriate action can be taken.

Duties and responsibilities should be divided to reduce the risk of error or fraud.
Examples of this segregation of duties include:

- separating the responsibility of authorizing transactions
- processing and recording the transactions
- reviewing the transactions.


Information

Internal Control (cont.)

Authorization and Access Restrictions

Timely Recording and Appropriate Documentation of Transactions and Internal Control

Transactions and events should only be authorized by those people who have been given the authority.

Access to certain funding and records should be limited to those individuals authorized. Accountability related to these items must be assigned and maintained. Funding records must be checked to make sure that the accountable person has authorized their use.

It is necessary to record transactions accurately and timely to maintain their relevance and value to regulate the organization and decision-making activities. This is important throughout the lifecycle of all transactions as any gross deviation could distort financial data.

Transactions must be clearly documented, and the documentation must be available for examination. Internal control must be documented in management directives, administrative policies, or operating manuals.

Now let's discuss control activities for information systems.

Detail

Internal Control (cont.)

Control Activities

General Control

Application Control

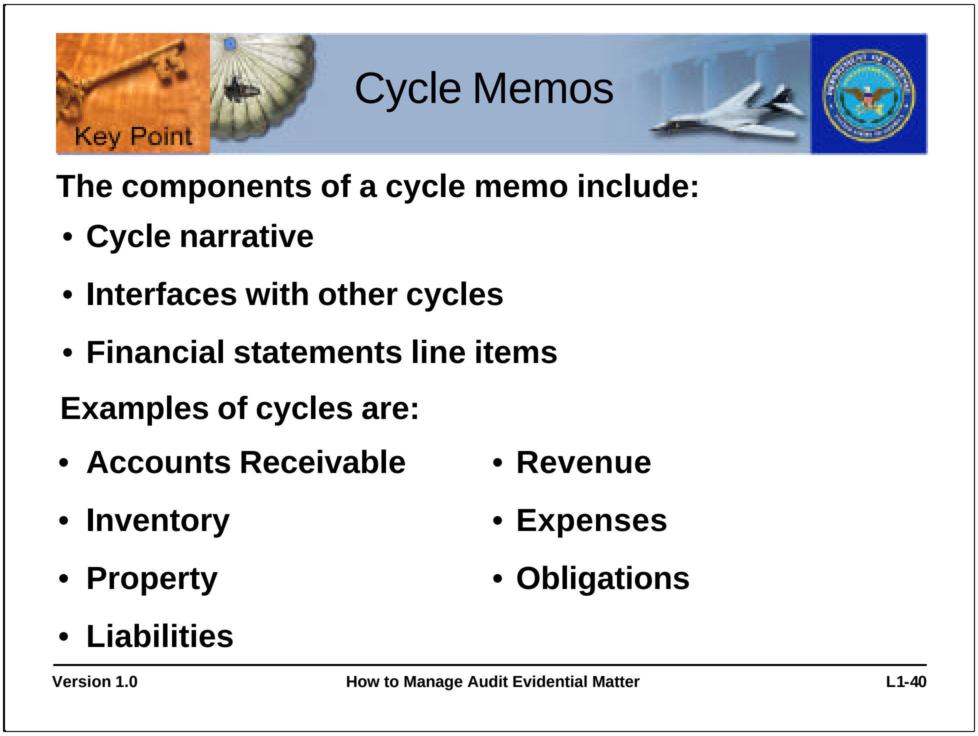
There are two groups of control activities that are specific to information systems, general control and application control.

General control activities include:

- entity-wide security program planning
- management
- control over data center operations
- system software acquisition and maintenance
- access security
- application system development and maintenance.

Application control ensures that data for your entity is prepared for entry and meets the completeness, accuracy authorization, and validity of all transactions. An example of an application control in payroll is special limited access to the system for timekeepers. The timekeepers can only post time and attendance. They do not have access to the part of the system that establishes pay rates or employment status. Other application control examples in payroll are verifying signatures on time cards, recording employee exception data accurately in the system, and reconciling payroll reports to your activity codes and the personnel on board.

Let's see how cycle memos play a part in the internal control process.



Cycle Memos

The components of a cycle memo include:

- **Cycle narrative**
- **Interfaces with other cycles**
- **Financial statements line items**

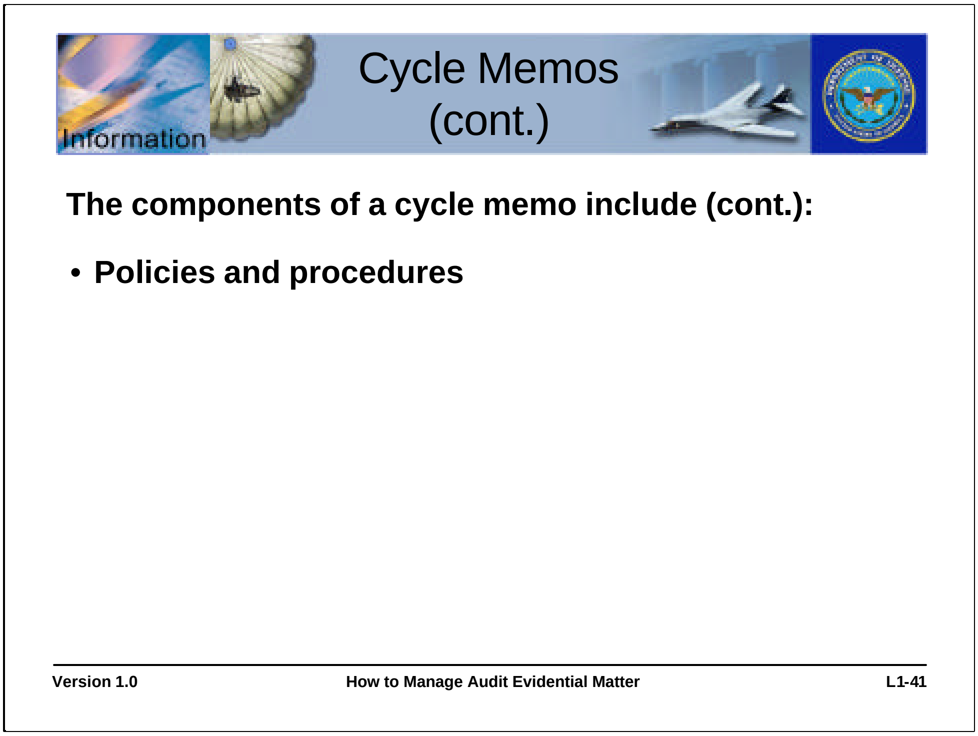
Examples of cycles are:

- **Accounts Receivable**
- **Inventory**
- **Property**
- **Liabilities**
- **Revenue**
- **Expenses**
- **Obligations**

Cycle memos are used to document internal control processes within an organization. These cycle memos provide narrative descriptions of the processes. A cycle process is a narrative representation of the sequence and content of your process. It explains what comes first, second, third, as well as documents prepared or received, and actions taken by personnel. As an additional tool, flowcharts are prepared to complement the narrative descriptions in the cycle memos.

It is important to be familiar with the process of preparing a cycle memo, so let's look at the component parts.

To prepare a cycle memo, document in a narrative form each significant event that is part of the cycle. Include a description of how this cycle interfaces with other cycles and non-financial and financial systems. Identify financial statements line items and general ledger accounts included in the cycle.


Information

Cycle Memos (cont.)

The components of a cycle memo include (cont.):

- **Policies and procedures**

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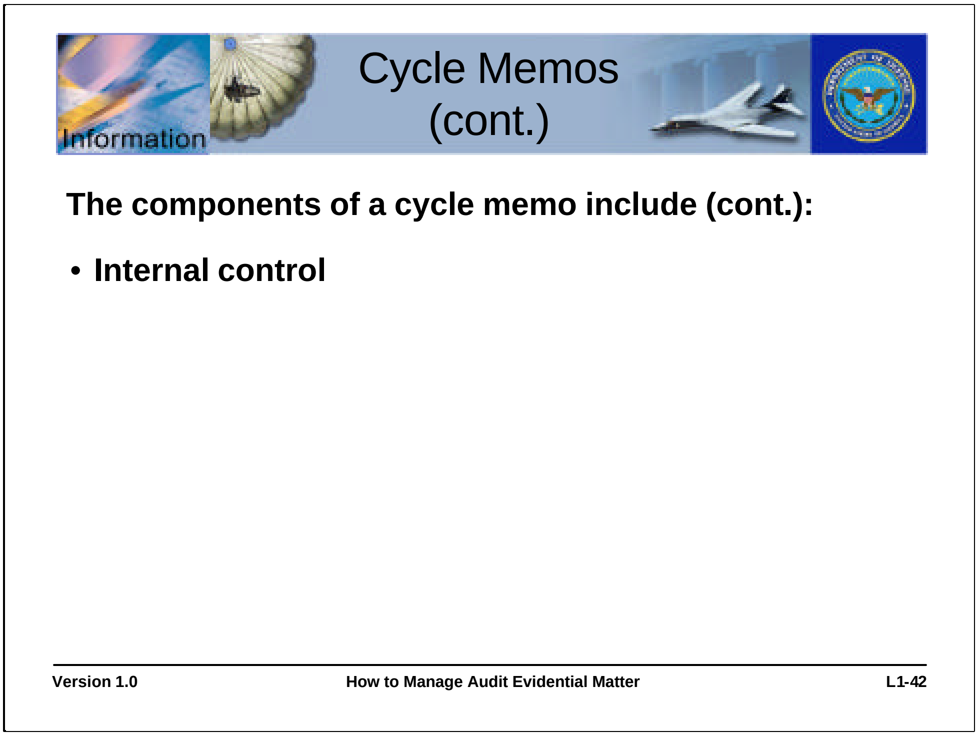
Include a description of the operating policies and procedures that relate to the processes to ensure that necessary actions are taken to address risks.

This description must include:

- an explanation of how policies and procedures are communicated to employees (in the form of policy and manuals)
- the process by which documents flow through the organization in order to properly record, process, summarize, and report.

Examples of these processes should include how the agency:

- initiates transactions
- identifies and records all valid transactions
- classifies transactions
- measures values
- uses and stores source documentation
- records transactions in the proper time period
- presents and discloses transactions
- communicate roles and responsibilities of employees
- uses computer systems to access, update, and delete files.



Information

Cycle Memos (cont.)

The components of a cycle memo include (cont.):

- **Internal control**

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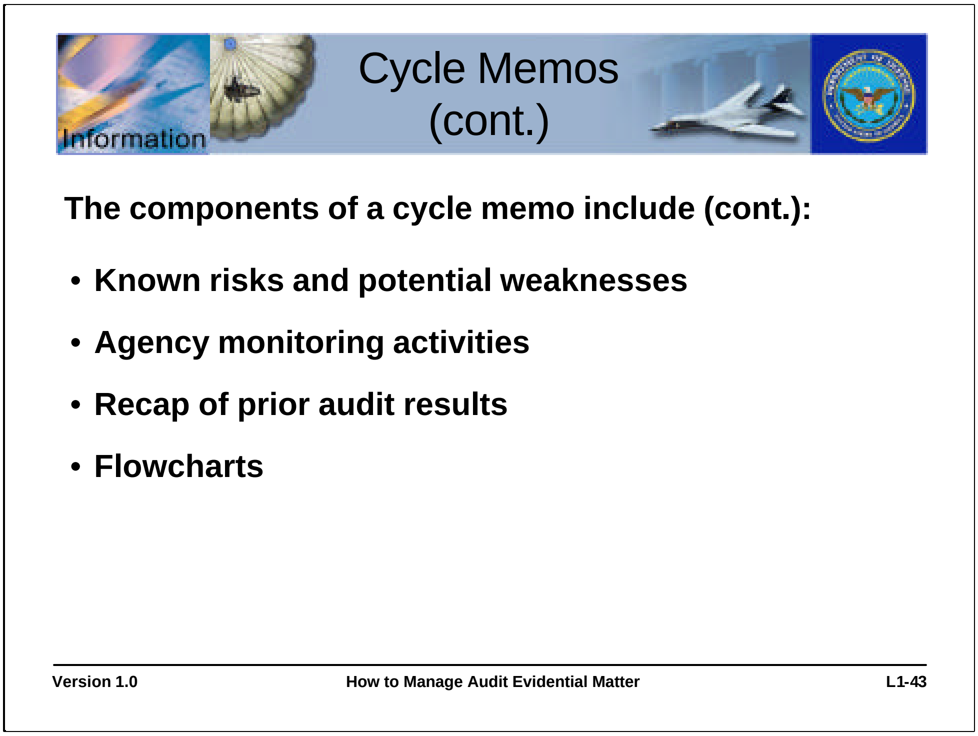
You must identify the major internal control by:

- discussing control objectives and their relationship to assertions
- discussing performance reviews (such as the analysis of actual performance, as opposed to budgeted performance)
- discussing information processing controls that monitor accuracy, completeness, and authorization of transactions.

These information processing controls include:

- agency access to assets
- recorded accountability of assets as compared to what actually exists, and appropriate action taken with respect to differences
- the recording of transactions as authorized by management
- the recording of transactions in conformity with Generally Accepted Accounting Principles (GAAP)
- activities that ensure physical security of assets or records, periodic counts, and reconciliations
- segregation of duties
- accessing control techniques (perform walkthroughs) and follow-up.


Information

Cycle Memos (cont.)

The components of a cycle memo include (cont.):

- **Known risks and potential weaknesses**
- **Agency monitoring activities**
- **Recap of prior audit results**
- **Flowcharts**

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You must describe, in detail, any known risks and potential weaknesses, and their effect on the financial statements, by identifying control objectives designed to prevent or detect the misstatements.

You must describe the agency's monitoring activities.

Monitoring activities include:

- internal auditors or other personnel who have communications about strength and weaknesses and recommendations for improving internal controls
- ongoing supervisory monitoring activities.

The processes described within the cycle memo can be detailed and difficult to understand. Flowcharts that help explain the process can be used to reinforce the narrative of the cycle memo. The flowchart must summarize the flow in terms of input and report documents, processing steps, files used, units involved, and interfaces with other cycles and applications.

Let's take a look at the three categories of control objectives.

Risks

Three Categories of Objectives

Financial Reporting **Compliance** **Operations**

Control objectives fall into three categories:

- reliability of financial reporting
- compliance with applicable laws and regulations
- effectiveness and efficiency of operations.

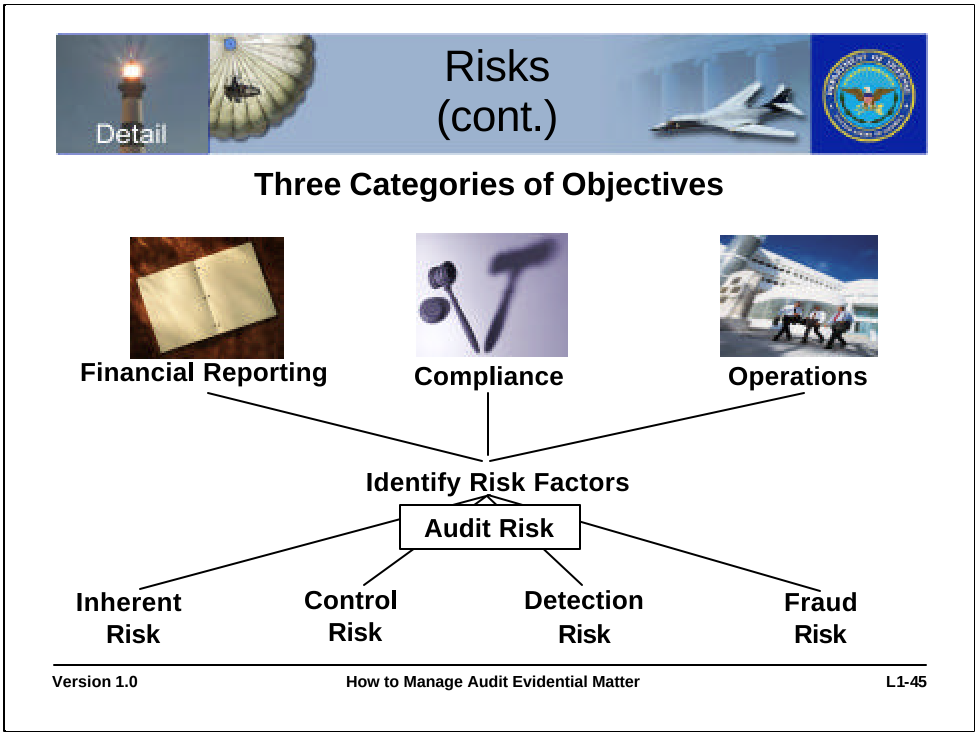
Financial reporting objectives are designed so that transactions are properly recorded, processed, and summarized in accordance with GAAP.

Compliance reporting objectives look to the implementation of laws and regulations for transactions that affect budget authority and could have a material effect on financial statements and other laws, regulation, and guidance identified by the OMB.

Operations reporting objectives include policies and procedures used to carry out organizational objectives such as planning, productivity, programmatic, quality, economy, efficiency, and effectiveness objectives.

You must identify risks within these categories. You must analyze and estimate the likelihood of their occurrence and decide what actions to take. What you identify as risks may be different from those identified by the auditors.

Let’s talk about identifying risk factors.



Detail

Risks (cont.)

Three Categories of Objectives

Financial Reporting

Compliance

Operations

Identify Risk Factors

Audit Risk

Inherent Risk

Control Risk

Detection Risk

Fraud Risk

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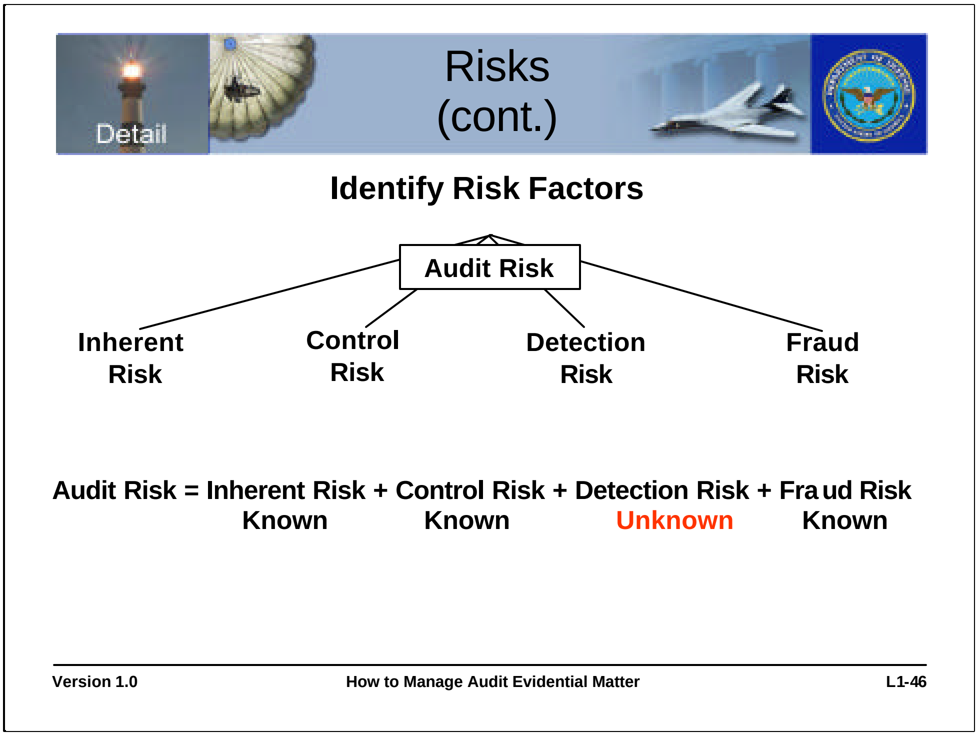
Let's review the definition of inherent risks and control risks.

Inherent risk is the susceptibility of an error due to the nature of your business.

Control risk is the risk that a material misstatement could occur in an assertion and not be prevented or detected on a timely basis by the entity's internal control. Remember, internal control has five components: control environment, risk assessment, monitoring, information and communication, and control activities.

Detection risk is the risk that the auditors will not detect a material misstatement that exists in an assertion.

Fraud risk is the risk of fraudulent financial reporting and the risk of misappropriation of assets that causes a material misstatement on the financial statements.



Risks (cont.)

Identify Risk Factors

Audit Risk

Inherent Risk | **Control Risk** | **Detection Risk** | **Fraud Risk**

Audit Risk =	Inherent Risk +	Control Risk +	Detection Risk +	Fraud Risk
	Known	Known	Unknown	Known

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Why is this important to know?

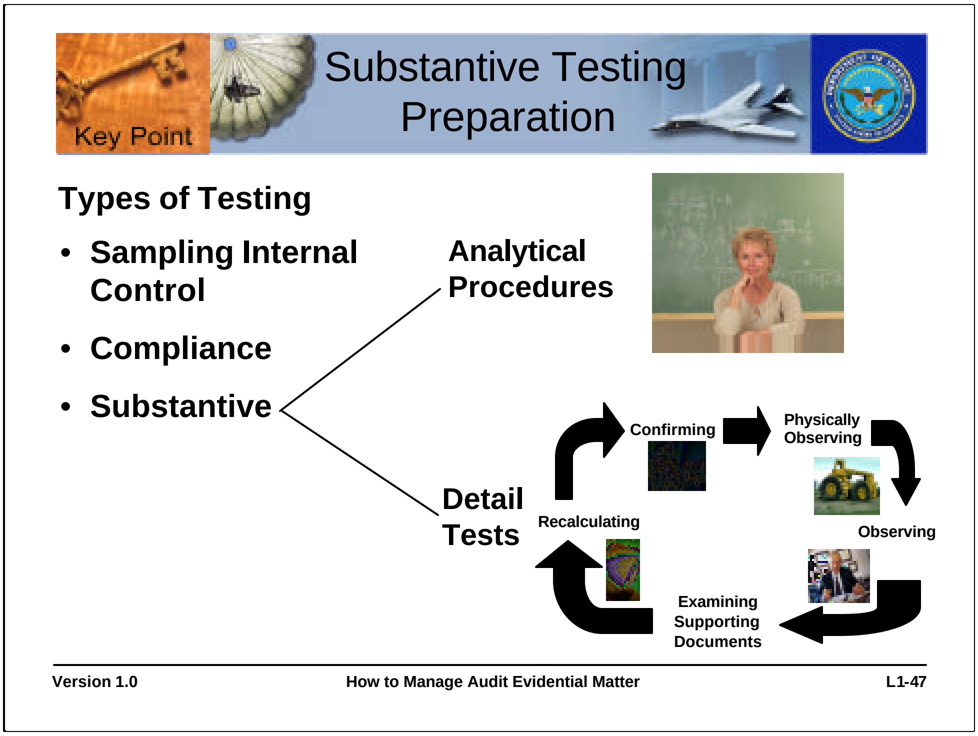
The level of audit risk determines the nature, timing, and extent of the substantive audit procedures necessary to achieve the resultant detection risk. Methods that can be used to determine the nature and timing of control test can include observation, inquiry, or inspection.

Observation is the observance of entity personnel performing control activities in the normal course of duties. Observation in itself does not provide evidence that the control has been in place and should be supplemented with corroborating information.

Inquiry is oral or written investigation by auditors of how entity personnel perform their duties. The auditors conduct inspection tests by examining documents and records for the existence of evidence such as initials or signatures that an entity has applied to a particular task.

Examples of inspections include using operations manuals and flowcharts of evidential matter to determine the propriety of tasks under examination.

Now that you have seen the various documentation, let's look at how substantive testing is used on samples.



Key Point

Substantive Testing Preparation

Types of Testing

- **Sampling Internal Control**
- **Compliance**
- **Substantive**

Analytical Procedures

Detail Tests

Confirming
Physically Observing
Observing
Examining Supporting Documents
Recalculating

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There are three types of testing that are completed in the testing phase of the audit. They are sampling internal control, compliance, and substantive.

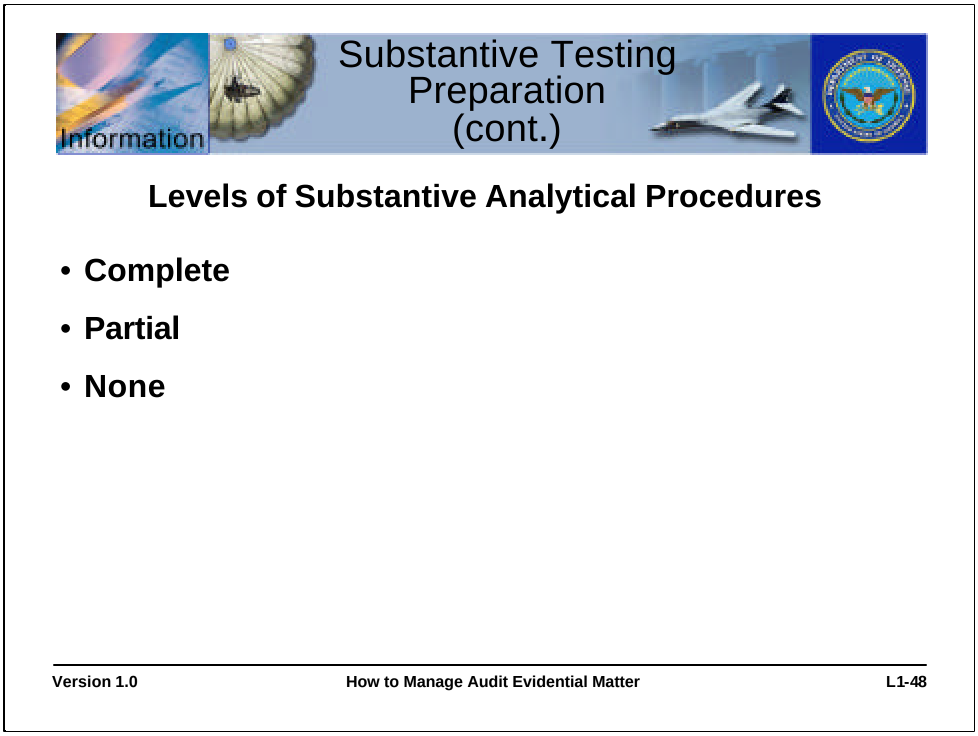
Sampling tests are performed on internal control to see if the entity has achieved the objective of that control.

Compliance tests are performed to see if the entity is in compliance with laws and regulations.

Substantive tests are performed to see if the information on the financial statements is correct.

While performing a substantive test, the auditors looks at individual line items on a financial statement to determine if there is adequate evidential matter supporting the figures. Within substantive tests, there are substantive analytical procedures and substantive detail tests.

Let’s talk about substantive analytical procedures.


Information

Substantive Testing Preparation (cont.)

Levels of Substantive Analytical Procedures

- **Complete**
- **Partial**
- **None**

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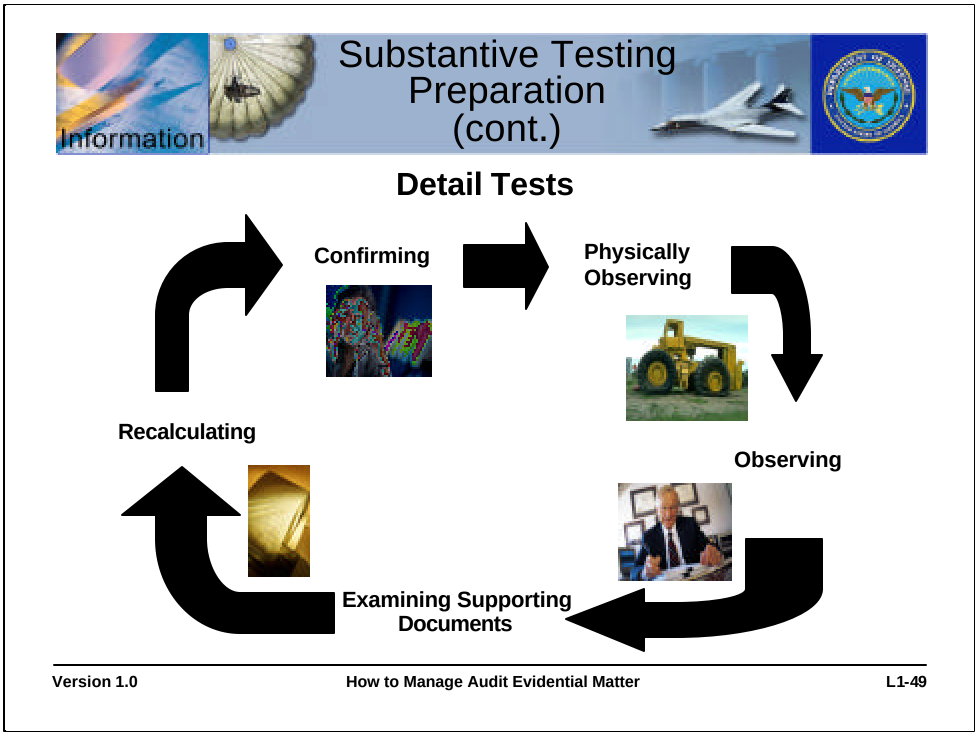
Substantive analytical procedures encompass a line item comparison of what auditors expect to see on a financial statement and the actual amount that appears. A basic premise of these procedures is that when a relationship exists between certain elements of financial data, it may continue to exist unless an event happens to change the relationship. When there are significant differences, the auditors investigate to determine why.

Substantive analytical testing is performed at three levels:

- complete
- partial
- none.

The complete level provides for the analytical procedure as the sole test. Using analytical procedures as the sole test is rare. The partial level is a combination of analytical and detail testing. In order for the test to be valid, the auditors must feel that the incidence of misstatement is virtually improbable and not material. The none level is a reliance on detail tests for assurance of test materiality.

Now let’s talk about detail tests.



Substantive Testing Preparation (cont.)

Detail Tests

Confirming

Physically Observing

Observing

Examining Supporting Documents

Recalculating

Version 1.0 How to Manage Audit Evidential Matter L1-49

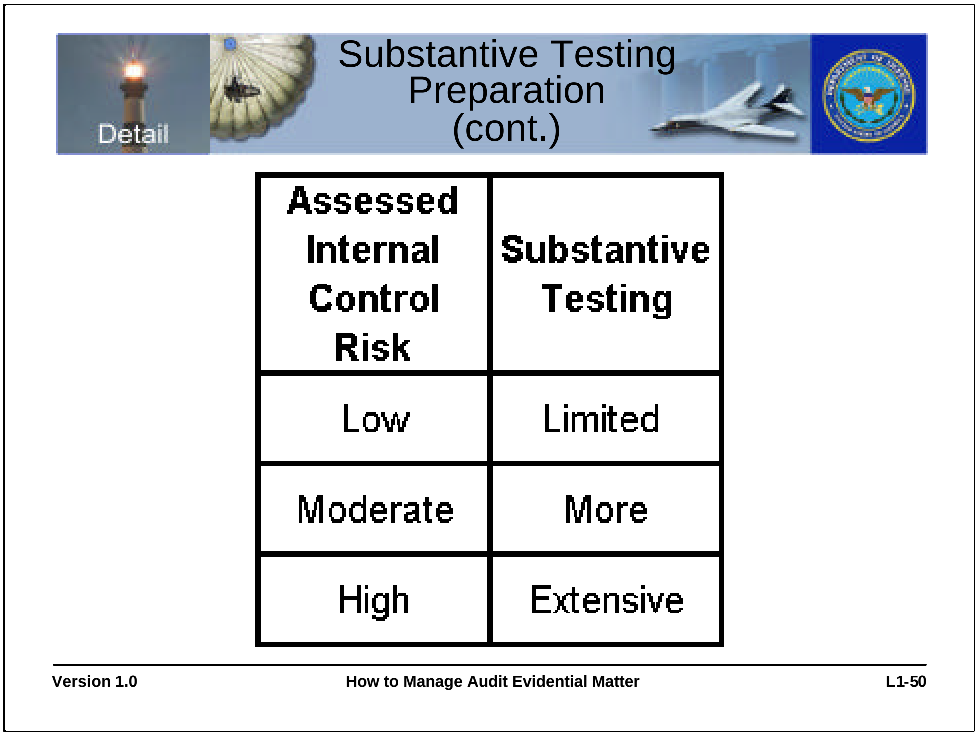
Detail tests include confirming, physically observing, observing, examining supporting documents, and recalculating. An example of confirming is the verification of a balance in a bank account.

An example of physically observing is when the auditors need to look at a specific piece of equipment to be certain that it exists and is in your possession. Observing involves reviewing or overseeing a process or event taking place.

An example of examining supporting documents is when auditors request supporting documents to verify that a transaction is valid and correct.

Recalculating is a matter of checking mathematical accuracy or checking journal entries to subsidiary ledgers and then to the GL.

Let’s look at the three levels of substantive analytical procedures and see how they are used together to provide a mix appropriate to a sample being tested.



Substantive Testing Preparation (cont.)

Assessed Internal Control Risk	Substantive Testing
Low	Limited
Moderate	More
High	Extensive

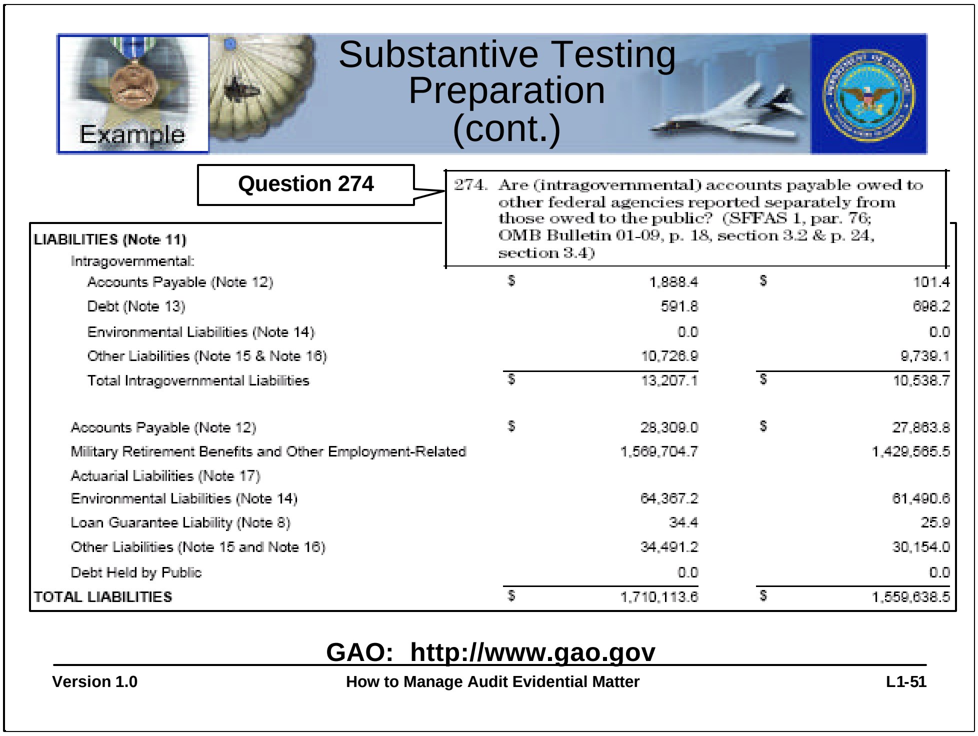
The combined risk is a combination of inherent risk and control risk. Control risk is the risk that a material misstatement could occur in an assertion and will not be prevented or detected on a timely basis by the entity's internal controls. Inherent risk is the susceptibility of an assertion to a material misstatement, assuming that there are no related specific control activities.

With a low assessed combined risk level, the auditors believe that the controls will prevent or detect any aggregate misstatement that could occur in the assertion in excess of design materiality.

With a moderate assessed combined risk level, the auditors believe that controls will more likely than not prevent or detect any aggregate misstatement that could occur in the assertion, in excess of design materiality.

With a high assessed combined risk level, the auditors believe that controls are unlikely to prevent or detect any aggregate misstatement that could occur in the assertion in excess of design materiality.

The quality of internal control determines the assessed risk level.



Substantive Testing Preparation (cont.)

Question 274

274. Are (intragovernmental) accounts payable owed to other federal agencies reported separately from those owed to the public? (SFFAS 1, par. 76; OMB Bulletin 01-09, p. 18, section 3.2 & p. 24, section 3.4)

LIABILITIES (Note 11)				
Intragovernmental:				
Accounts Payable (Note 12)	$	1,888.4	$	101.4
Debt (Note 13)		591.8		698.2
Environmental Liabilities (Note 14)		0.0		0.0
Other Liabilities (Note 15 & Note 16)		10,726.9		9,739.1
Total Intragovernmental Liabilities	$	13,207.1	$	10,538.7
Accounts Payable (Note 12)	$	28,309.0	$	27,863.8
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)		1,569,704.7		1,429,565.5
Environmental Liabilities (Note 14)		64,367.2		61,490.6
Loan Guarantee Liability (Note 8)		34.4		25.9
Other Liabilities (Note 15 and Note 16)		34,491.2		30,154.0
Debt Held by Public		0.0		0.0
TOTAL LIABILITIES	$	1,710,113.6	$	1,559,638.5

GAO: http://www.gao.gov

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Auditors use the GAO/PCIE FAM Checklist for Accounting, Reporting, and Disclosures to complete the audit. Questions 1 through 355 deal with the Balance Sheet.

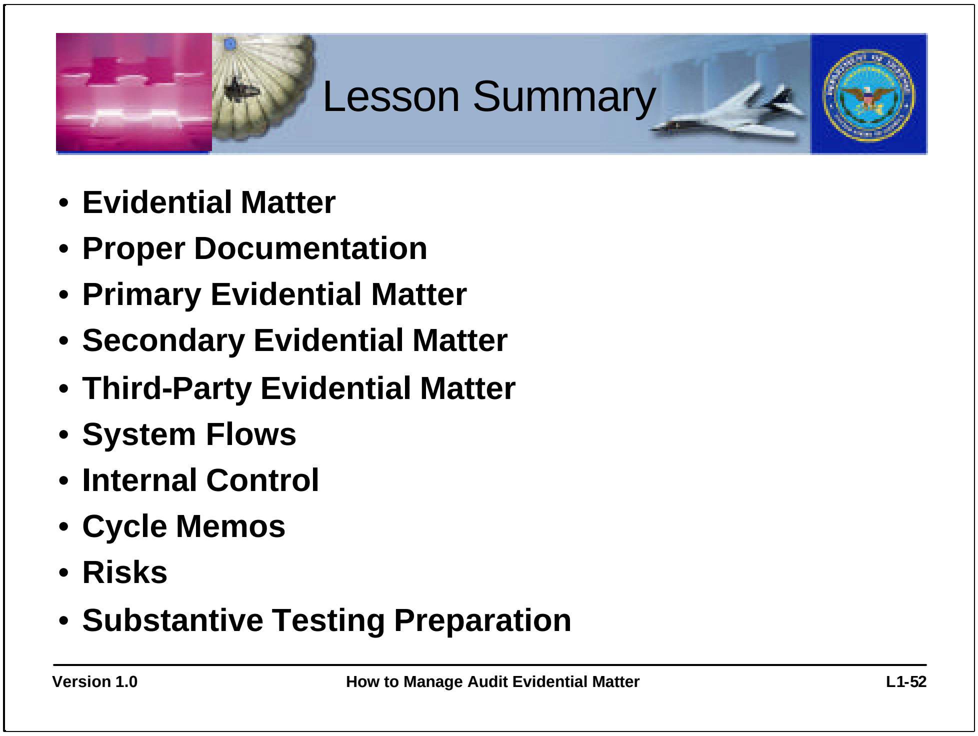
In this example, let’s look at Question 274 from the FAM checklist.

“Are (intragovernmental) accounts payable owed to other federal agencies reported separately from those owed to the public?”

Auditors apply substantive testing based on:

- an appropriate sample size
- characteristics of the evidential matter supporting the population
- an assigned level of materiality
- an acceptable level of risk for the particular line item.

Let’s summarize what we learned in this lesson.



Lesson Summary

- **Evidential Matter**
- **Proper Documentation**
- **Primary Evidential Matter**
- **Secondary Evidential Matter**
- **Third-Party Evidential Matter**
- **System Flows**
- **Internal Control**
- **Cycle Memos**
- **Risks**
- **Substantive Testing Preparation**

In this lesson, you learned about the types of documentary evidence that auditors use as evidential matter to support their audit opinions.

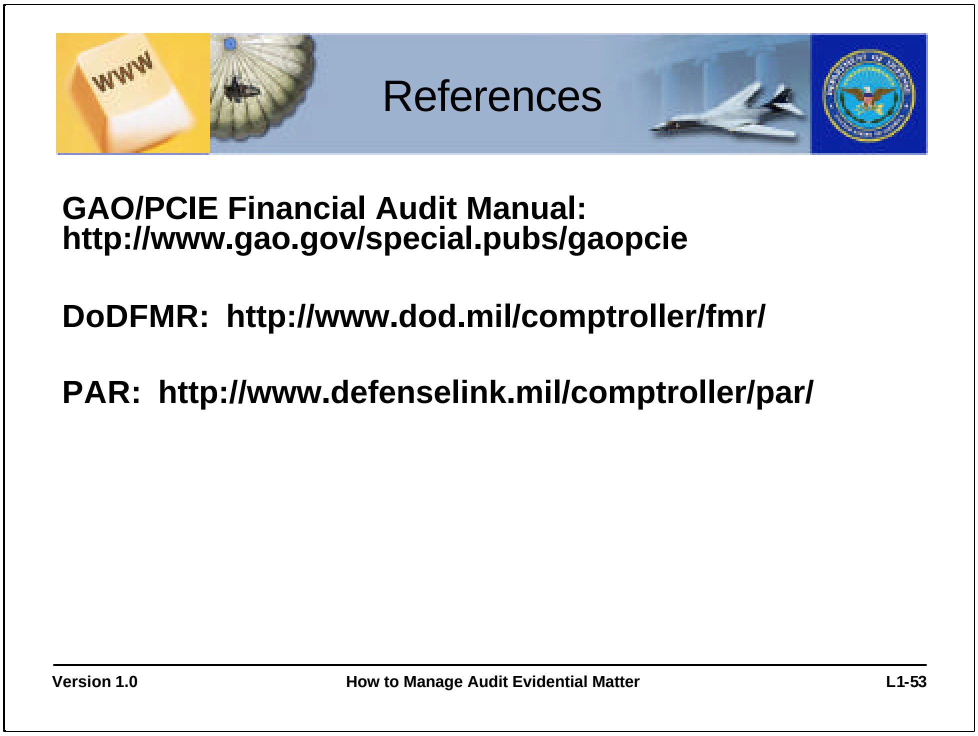
You learned that complete reliance on analytical evidence is improbable.

You learned about primary, secondary, and third-party evidential matter and its impact on an auditors opinion. System flows showed you how subsidiary data from financial systems, non-financial systems, manually prepared compilations, and other direct inputs are the basis for the primary accounting system outputs.

You learned how to produce cycle memos to document internal control processes. Control activities and risk assessments were identified, as they relate to an organization’s plans, methods, and procedures.

Finally, you learned about the two types of substantive testing: analytical and detail. Analytical testing is a comparison of actual amounts to expected amounts. Detail tests involved corroborative evidence such as confirming, physically observing, examining supporting documents, and recalculating.

The following slide lists references available for additional information.

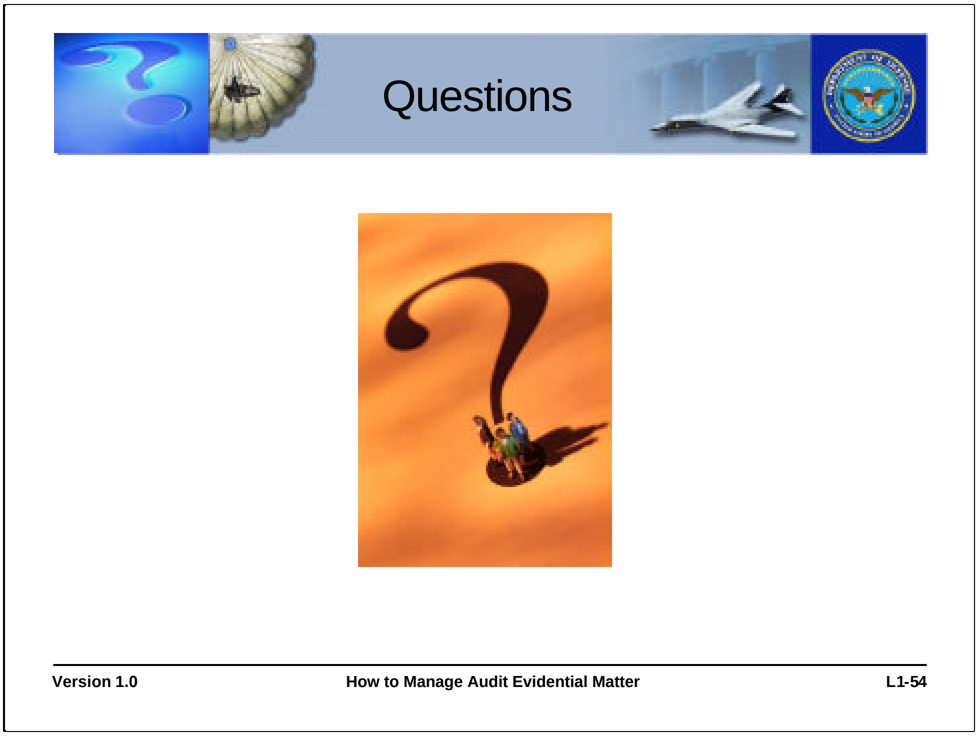


References

GAO/PCIE Financial Audit Manual: http://www.gao.gov/special.pubs/gaopcie

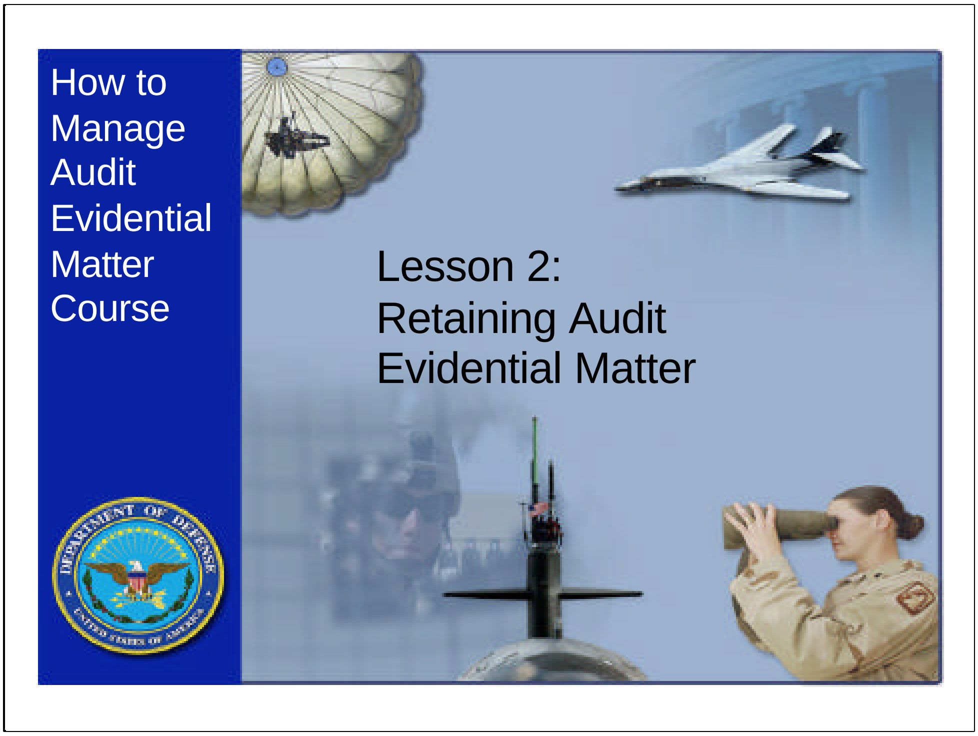
DoDFMR: http://www.dod.mil/comptroller/fmr/

PAR: http://www.defenselink.mil/comptroller/par/



Questions

Do you have any questions on the material covered in this lesson?

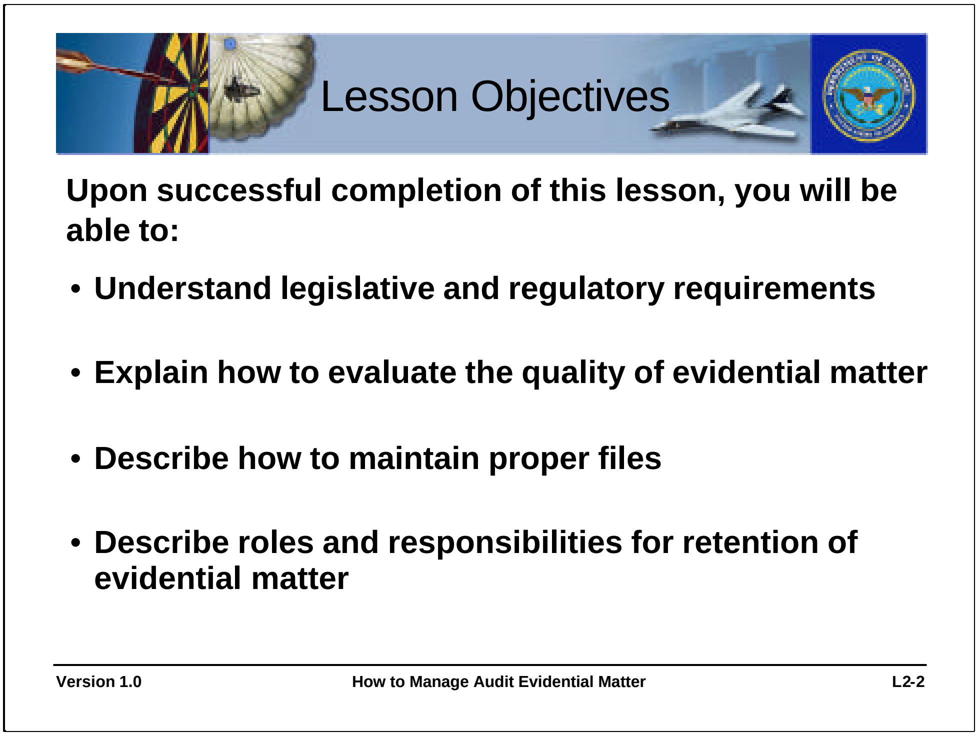


How to Manage Audit Evidential Matter Course

DEPARTMENT OF DEFENSE
UNITED STATES OF AMERICA

Lesson 2:
Retaining Audit Evidential Matter

In Lesson 2, we explore the process to retain quality evidential matter to support the balances and related notes in the Department’s financial statements.

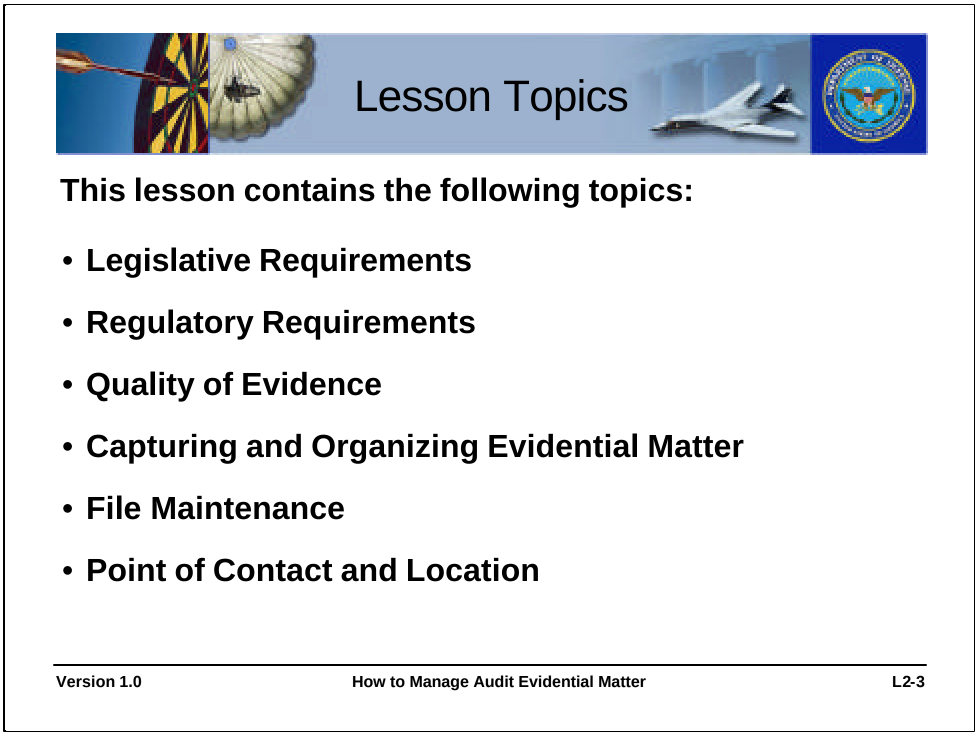


Lesson Objectives

Upon successful completion of this lesson, you will be able to:

- **Understand legislative and regulatory requirements**
- **Explain how to evaluate the quality of evidential matter**
- **Describe how to maintain proper files**
- **Describe roles and responsibilities for retention of evidential matter**

Lesson 2 explains the legislative and regulatory requirements for the retention of audit evidential matter. How to evaluate the quality of the evidential matter and maintain this information so it is ready for the auditors is discussed. It further explains who is responsible for maintaining the information and where it is located.



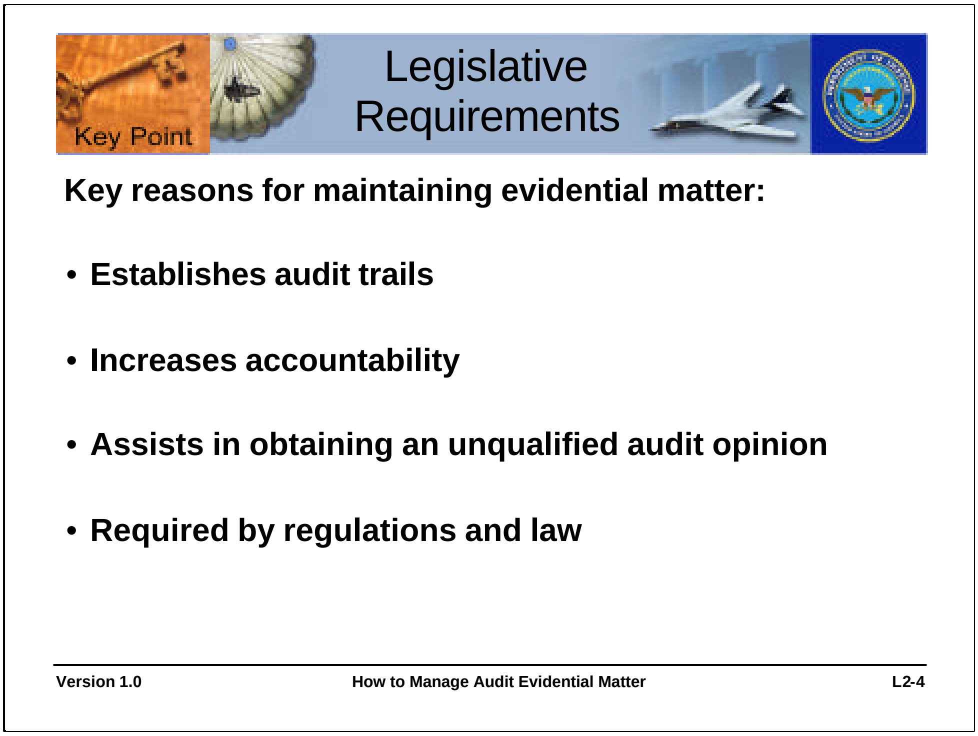
Lesson Topics

This lesson contains the following topics:

- **Legislative Requirements**
- **Regulatory Requirements**
- **Quality of Evidence**
- **Capturing and Organizing Evidential Matter**
- **File Maintenance**
- **Point of Contact and Location**

This lesson contains these topics. Legislative requirements gives the legal basis for the regulation and SOPs that each agency and installation has adopted with respect to the retention of evidential matter. Regulatory requirements looks at agency level requirements for the retention of evidential matter. Quality of evidence looks at the factors that an auditor uses to determine the competence of evidential matter.

Let’s begin with legislative requirements.



Legislative Requirements

Key reasons for maintaining evidential matter:

- **Establishes audit trails**
- **Increases accountability**
- **Assists in obtaining an unqualified audit opinion**
- **Required by regulations and law**

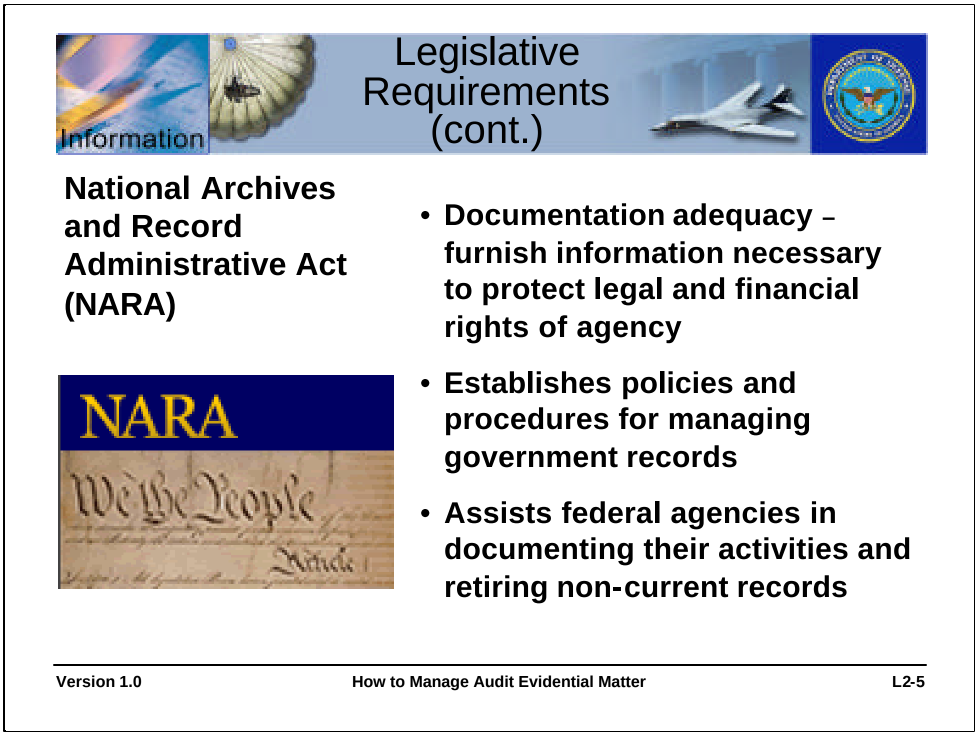
Version 1.0 How to Manage Audit Evidential Matter L2-4

The Federal Managers Financial Integrity Act (FMFIA) established compliance and requirements for federal agencies for obligations, safeguarding of assets, and properly recording of revenues and expenditures. When audit trails are established, accountability in these areas is properly supported.

The Government Performance and Results Act (GPRA) was enacted to hold agencies accountable for their program's results. Fiscal accountability is increased when there is evidential matter available to support areas such as establishing standards, defining missions, preparing plans, measuring performance, and identifying performance gaps and performance goals.

The Office of Management and Budget (OMB) Circular A-123 strengthened the requirement for conducting management's assessment of internal control. When audit trails for financial transactions are established as mentioned in the DoDFMR, accountability and effectiveness of operations are increased. You know that relevant, sufficient, and competent evidential matter is necessary to afford a reasonable basis for an unqualified audit opinion. Most of the auditor's work involves obtaining and evaluating evidential matter to test the fair presentation of the financial statements.

Audit trails are not just for auditors. They are used by DoD personnel every day to properly maintain internal control.


Information
NARA
We the People
Article

Legislative Requirements (cont.)

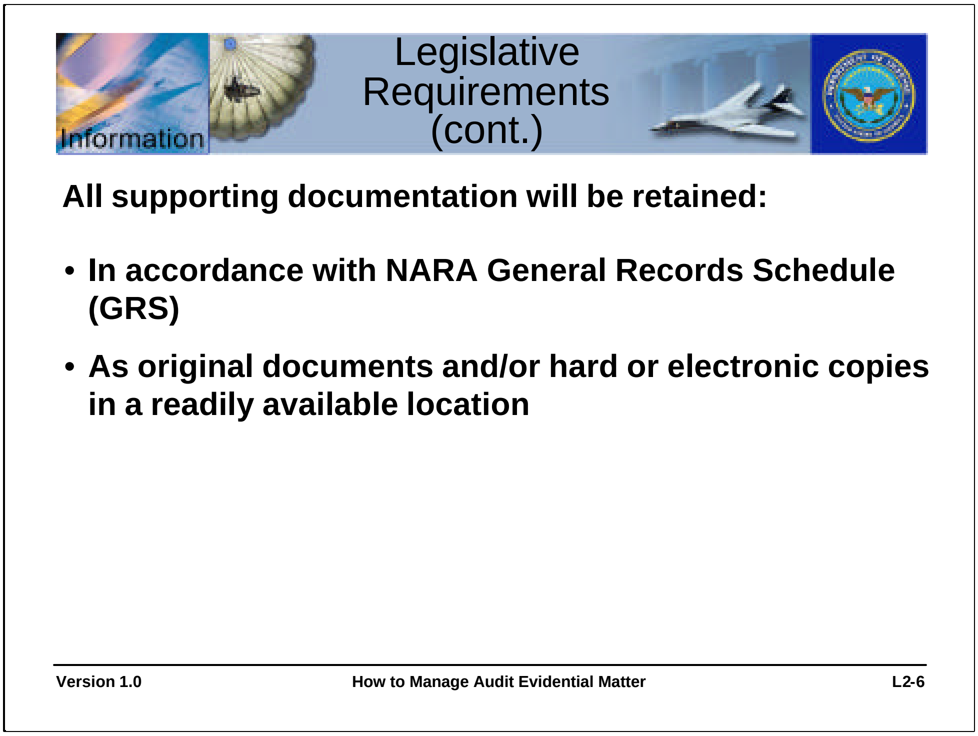
National Archives and Record Administrative Act (NARA)

- **Documentation adequacy – furnish information necessary to protect legal and financial rights of agency**
- **Establishes policies and procedures for managing government records**
- **Assists federal agencies in documenting their activities and retiring non-current records**

The National Archives and Record Administrative (NARA) Act of 1984 establishes the requirements for the retention of evidentiary matter. It divides records management responsibilities between the NARA and the General Services Administration (GSA).

NARA is the primary authority for record retention and is responsible for the adequacy of documentation and records disposition. In order for documentation to be adequate, an organization’s function, policies, decisions, and procedures must be complete and accurate. Adequacy of documentation is designed to furnish the information necessary to protect the legal and financial rights of government agencies and of persons directly affected by the agencies’ activities. NARA establishes policies and procedures for managing U.S. government records and assists federal agencies in documenting their activities, administering records management programs, scheduling records, and retiring non-current records.

Now that we discussed legislative requirements, let’s look at the regulatory requirements that are use at the agency level.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Legislative Requirements (cont.)

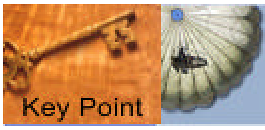
All supporting documentation will be retained:

- **In accordance with NARA General Records Schedule (GRS)**
- **As original documents and/or hard or electronic copies in a readily available location**

The NARA procedures are briefly discussed in Volume 1, Chapter 9, of the DoDFMR. The DoDFMR also contains a link to the General Records Schedule (GRS). The GRS provides retention and disposal authorization guidelines for records common to several or all agencies of the federal government. Examples of the types of records that GRS gives guidance on are civilian personnel, fiscal accounting, procurement, communication, and printing. In summary, it states that all supporting documentation should be retained in a readily available location. This means you already have to know what the auditors would need to see. If you have documentation, paper or electronic, that supports a line item on your financial statements, it must be retained. Keep anything supporting financial statements both electronic and hard copy.

Typical kinds of documentation include:

- invoices
- contracts
- receipt/acceptance documents
- work orders
- other third-party documentation (generated independently of the entity in possession of the property).



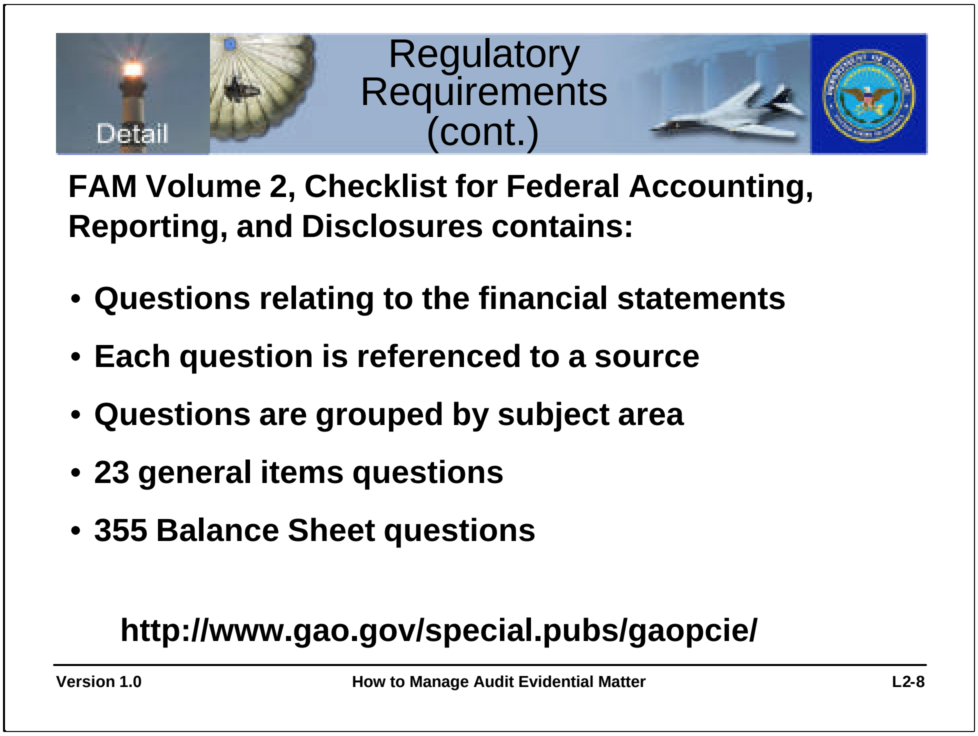
Regulatory Requirements

The Government Accountability Office (GAO)/ President's Council on Integrity and Efficiency (PCIE) Financial Audit Manual (FAM) includes:

- **Volume 1, Methodology – describes the audit process**
- **Volume 2, Tools – contains the Checklist for Federal Accounting, Reporting, and Disclosures**

The FAM is comprised of two volumes. Volume 1 describes the audit process, and Volume 2 contains the Checklist for Federal Accounting, Reporting, and Disclosures. In addition, it contains guidance for writing internal controls.

Let's take a look at Volume 2 and discuss the Checklist for Federal Accounting, Reporting, and Disclosures.



Detail

Regulatory Requirements (cont.)

FAM Volume 2, Checklist for Federal Accounting, Reporting, and Disclosures contains:

- **Questions relating to the financial statements**
- **Each question is referenced to a source**
- **Questions are grouped by subject area**
- **23 general items questions**
- **355 Balance Sheet questions**

http://www.gao.gov/special.pubs/gaopcie/

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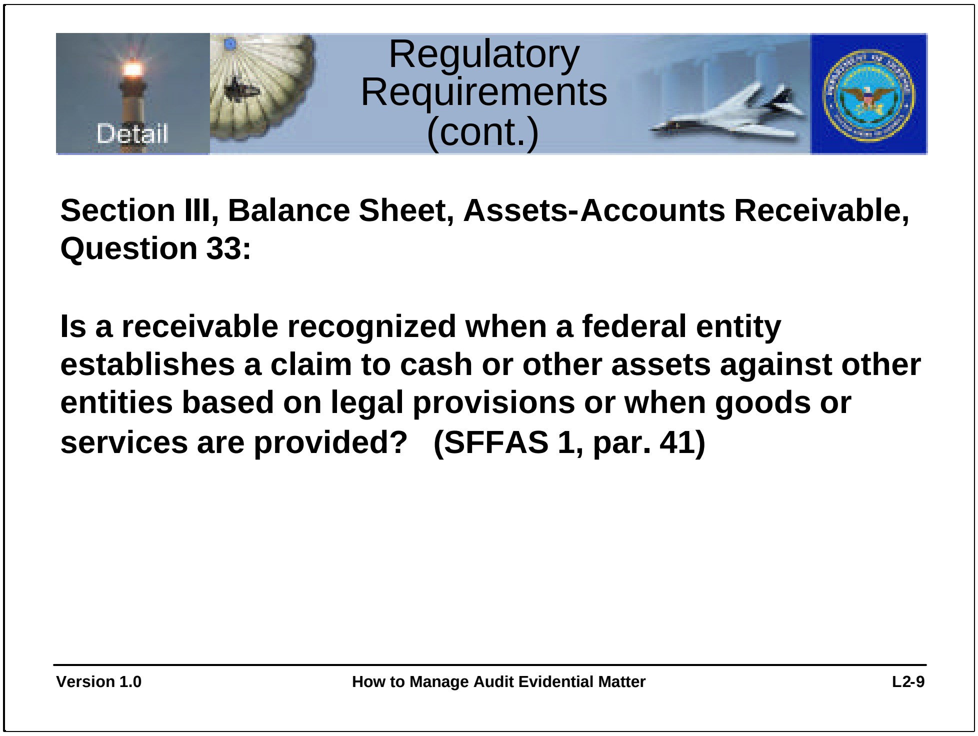
The checklist contains questions relating to the financial statements beginning with general items related to the statements, and then to each of the statements, notes, and supplementary information. Each question is referenced to a source. The sources cited are the Statements of Federal Financial Accounting Standards (SFFAS) and OMB Bulletin 01-09, Form and Content of Agency Financial Statements. These questions should serve as the types of questions that you could expect during an interview with the auditor completing the audit.

Questions are grouped by subject area. For example, there are 23 general items questions related to the financial statements and 355 questions related to the Balance Sheet. Since the financial statements are interrelated, some questions concerning line items in one financial statement may also pertain to line items in another statement.

For example, the questions covering loans receivable on the Balance Sheet section may also deal with matters related to interest income and subsidiary expense appearing in the statements of financing and net cost sections. For this reason, questions on related line items appearing in more than one financial statement are covered only in the first financial statement section in which the line item appears. Auditors may ask other related questions concerning receivables such as the status of delinquent accounts and policies used by your organization to recover bad debts.

Let's examine a few sample questions.



Regulatory Requirements (cont.)

Section III, Balance Sheet, Assets-Accounts Receivable, Question 33:

Is a receivable recognized when a federal entity establishes a claim to cash or other assets against other entities based on legal provisions or when goods or services are provided? (SFFAS 1, par. 41)

This question is extracted from the section of the checklist relating to the Balance Sheet. The affected line on the Balance Sheet that is the focus of this question is Accounts Receivable. Next, notice that the phrasing of the question is a restatement of an accounting rule that has to do with the timing of the recognition of an account receivable. Each question may be answered by Yes, No, or N/A, and space is available at the side of each question for explanation or auditor comments.

The following are some questions that should be considered.

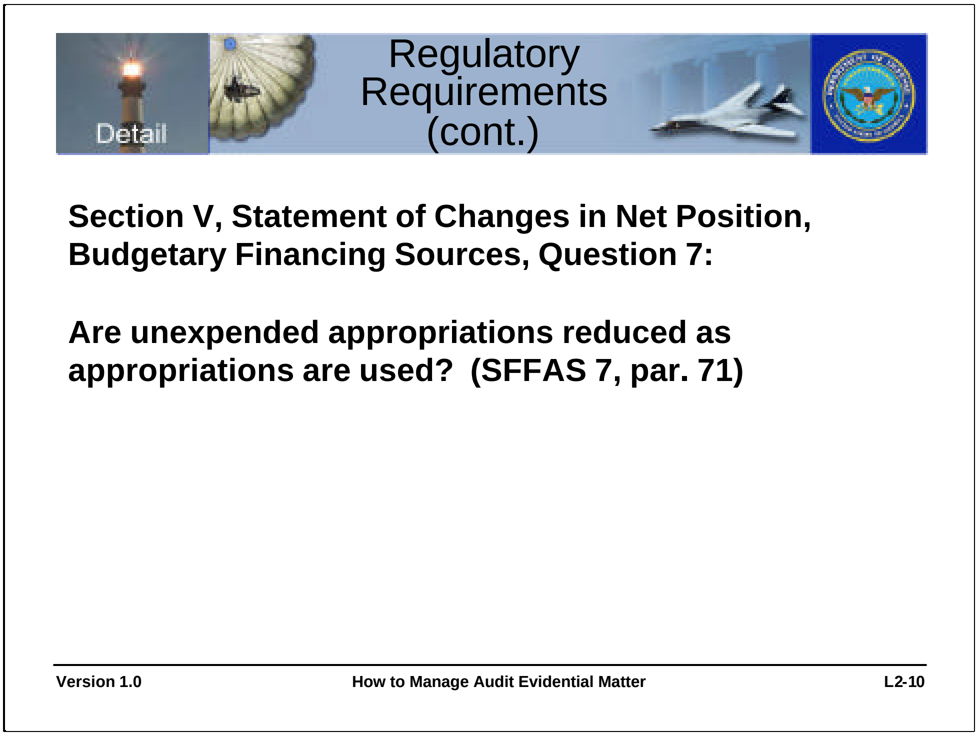
How would the auditor determine how and when an organization recognizes an account receivable?

What specific procedures are in place in the organization to provide instruction on receivables? (DoDFMR, Training, Systems)

Based on original document dates, are specific procedures followed?

How many documents should be examined to verify that the organization (as a whole) is in compliance with this accounting rule?

Let’s look at Section V of the FAM checklist.



Regulatory Requirements (cont.)

Section V, Statement of Changes in Net Position, Budgetary Financing Sources, Question 7:

Are unexpended appropriations reduced as appropriations are used? (SFFAS 7, par. 71)

This section of the checklist relates to the Statement of Changes in Net Position. The affected line on the statement that is the focus of this question is the Unexpended Appropriations line. To understand how the auditor determines whether Unexpended Appropriations are reduced as appropriations are used, think about what kind of questions the auditor may be required to ask. Let’s examine a few.

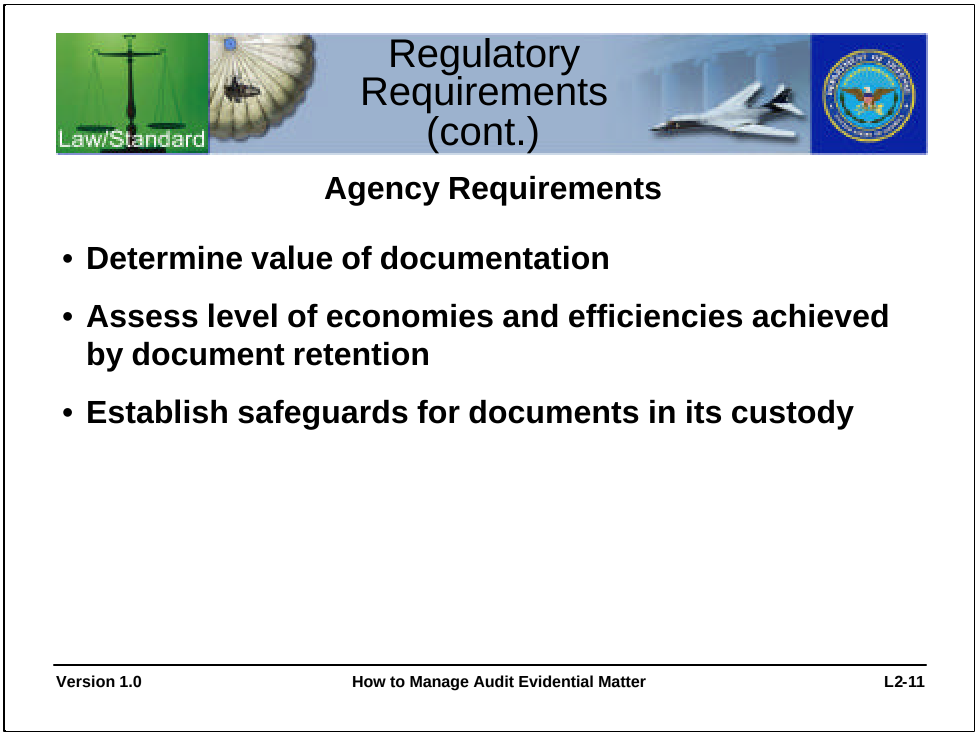
What specific procedures are in place in the organization to adjust the unexpended appropriations totals as the appropriations are used? (DoDFMR, automated systems, controls)

Based on original document dates, are specific procedures followed? (obligation and payment documents)

Are manual adjustments necessary to ensure that appropriations are reduced? If so, when are accounts adjusted?

What must be done to test each system to verify that the organization (as a whole) is in compliance with this accounting rule?

Now let’s explore agency level regulation and responsibilities for retention of evidential matter.


Law/Standard

Regulatory Requirements (cont.)

Agency Requirements

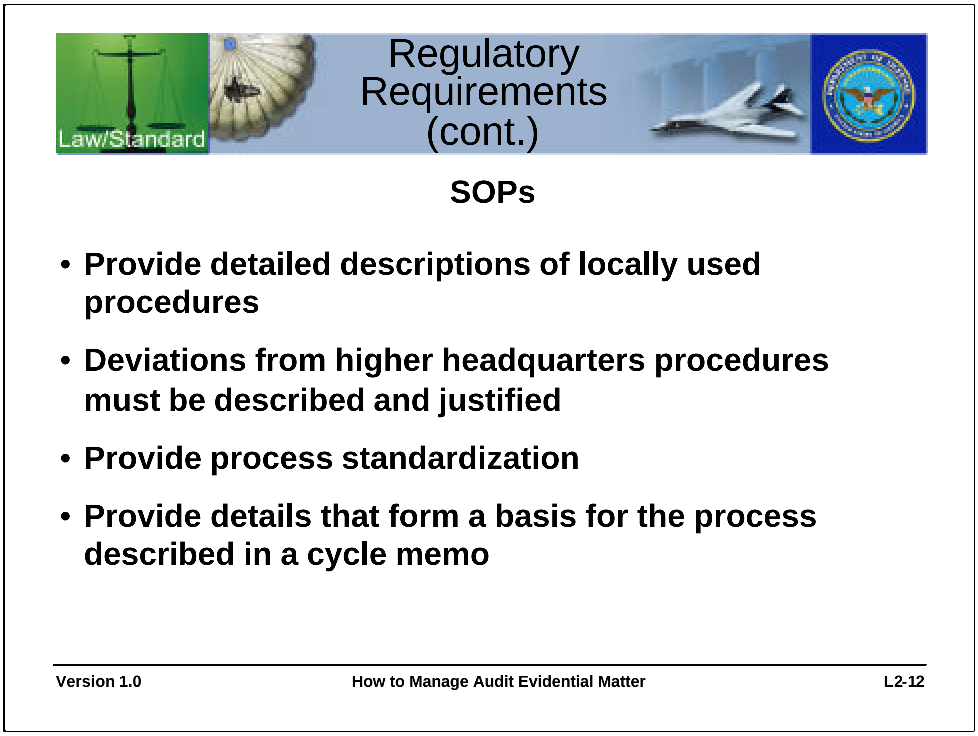
- **Determine value of documentation**
- **Assess level of economies and efficiencies achieved by document retention**
- **Establish safeguards for documents in its custody**

Agencies preserve records containing the proper documentation to support the organization’s functions, policies, decisions, procedures, and essential transactions.

Agency heads must determine that the documentation has value and that there are substantial economies and increased efficiencies that can be obtained through document retention. Agency document retention can be affected through record centers maintained by the GSA or by establishment of a records center of its own.

When documents are retrieved from a records center, officials authorized by the government certify that the documentation received is genuine. Safeguards must be established for records in the custody of the agency. They are not to be conveyed, transferred, or destroyed except in accordance with the agency’s established retention periods. Examples of Defense Finance and Accounting Service (DFAS) Central Site regulations that implement agency’s guidelines are the DFAS-IN 37-1 and the DFAS-DE 7010.1-R.

Now that we’ve discussed agency requirements, let’s talk about SOPs.


Law/Standard

Regulatory Requirements (cont.)

SOPs

- **Provide detailed descriptions of locally used procedures**
- **Deviations from higher headquarters procedures must be described and justified**
- **Provide process standardization**
- **Provide details that form a basis for the process described in a cycle memo**

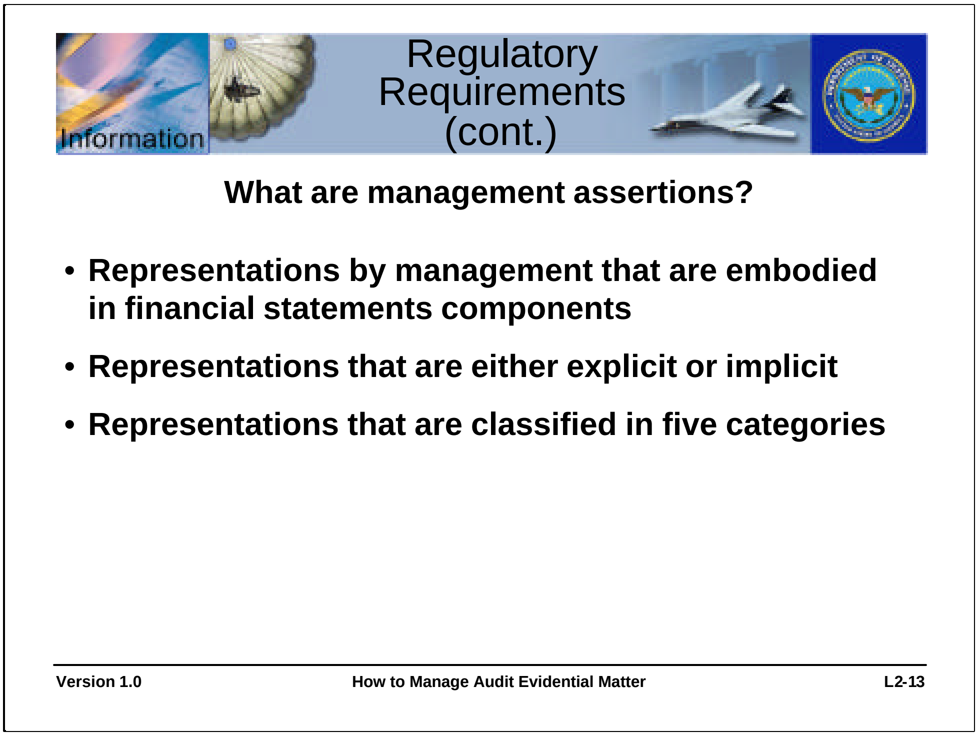
SOPs provide a detailed description of locally used procedures. Any deviation from the higher level approved procedures must be clearly described and justified and approved in writing. SOPs provide standardization of certain processes. They complement regulatory guidance and are used to direct processes within the organization towards regulatory compliance.

Some examples of items found on an SOP for the DFAS Vendor Pay Product Line are:

- deviations must receive approval from the Director of Resource Management
- use of the Standard Document Number as the obligation reference number
- use of a government purchase card as a payment instrument for goods and services
- special external certified payment procedures for attorney fees, apprehension awards, and reimbursements and confinement costs, awards for suggestions, child care, claims from class A agents, and clothing.
- related to Cycle Memo or can be used to develop a cycle memo.

The point here is that each SOP has its genesis with a regulation that requires it's existence. Auditors need to review SOPs and see if the organization is retaining evidentiary matter in accordance with the letter of the procedure.

Now let's discuss management assertions.



Information

Regulatory Requirements (cont.)

What are management assertions?

- **Representations by management that are embodied in financial statements components**
- **Representations that are either explicit or implicit**
- **Representations that are classified in five categories**

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Management assertions are different from the assertion process phases. These phases will be discussed later. Management assertions:

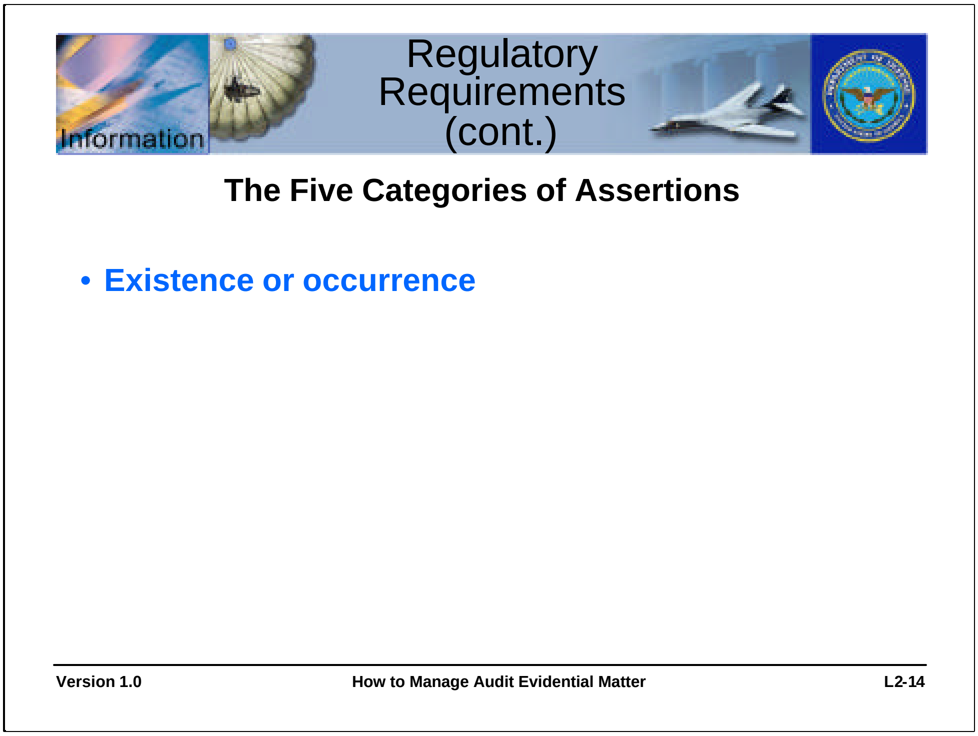
- are representations by management that are embodied in financial statements components
- can be either explicit or implicit
- can be classified in five categories.

These will be explained in some detail later in the lesson.

During an audit, management makes representations to the auditor both oral and written, in response to specific inquiries or through the financial statements. Such representations from management are part of the evidential matter the independent auditor obtains. That evidential matter may be supported by documents created at the lowest level of the Department operations.

An auditor's work in forming an opinion on financial statements consists of determining if balances and notes presented in the Department's financial statements fairly represent the operations of the entity at the lowest levels (Statements of Auditing Standards 31, Evidential Matter). After obtaining evidential matter in support of financial statements assertions, the auditor develops audit objectives and designs substantive tests for those assertions. These substantive tests are methods used to verify and validate the information.

Now let's look at the five broad categories of assertions.


Information

Regulatory Requirements (cont.)

The Five Categories of Assertions

- Existence or occurrence

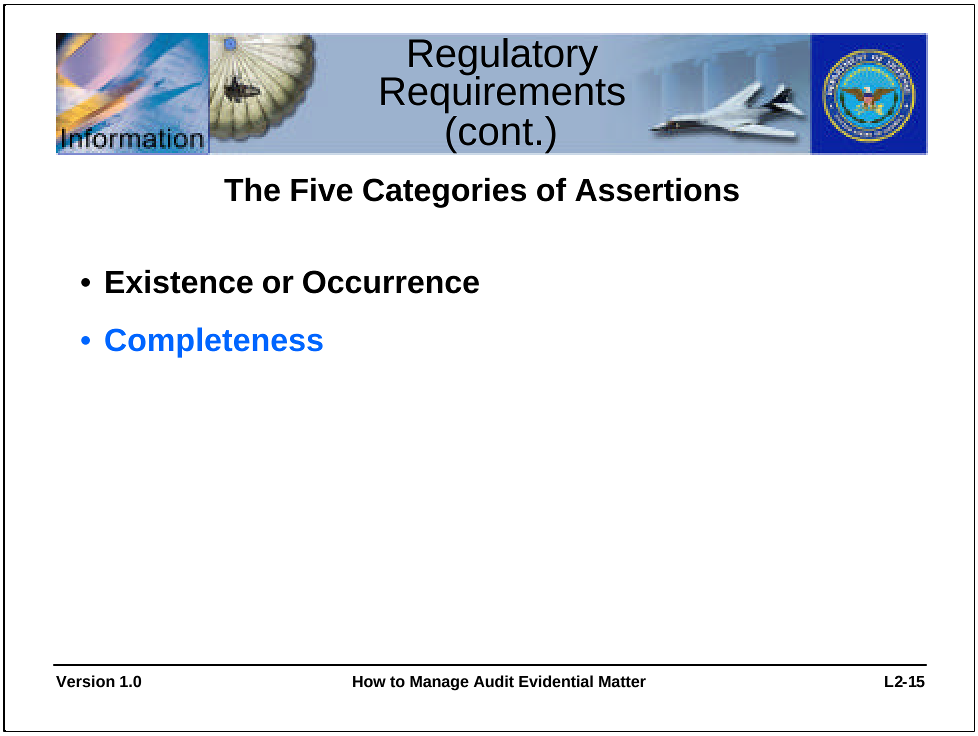
When auditors are presented with these assertions by management, they develop their audit objectives.

An assertion made by management about existence or occurrence addresses whether assets or liabilities exist at a given date and whether recorded transactions have occurred during a given period.

For example, in the existence or occurrence category, management asserts that all of the inventory included in the Balance Sheet physically exists. The auditors develop substantive tests to verify this assertions made by management.

The auditors test this assertion through observing physical inventory counts, obtaining confirmation of inventories at locations outside of the entity, or testing inventory transactions between a preliminary physical inventory date and the Balance Sheet date.

Let’s discuss the next category completeness.



Information

Regulatory Requirements (cont.)

The Five Categories of Assertions

- **Existence or Occurrence**
- **Completeness**

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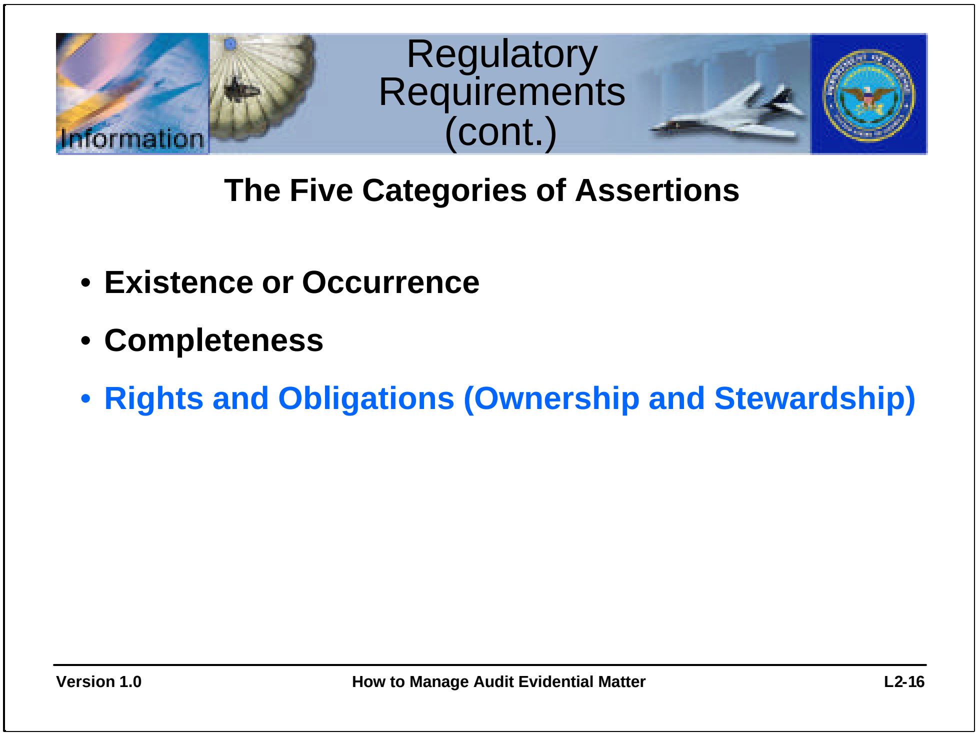
An assertion made by management about completeness addresses whether all transactions and accounts that should be presented in the financial statements are included.

For example, the Department asserts that all purchases of goods and services are included in their financial statements. Based on this assertion by the Department, the auditor would conduct substantive tests to determine if all of the goods and services are included in the financial statements.

Let’s discuss the assertion category rights and obligations.



Information

Regulatory Requirements (cont.)

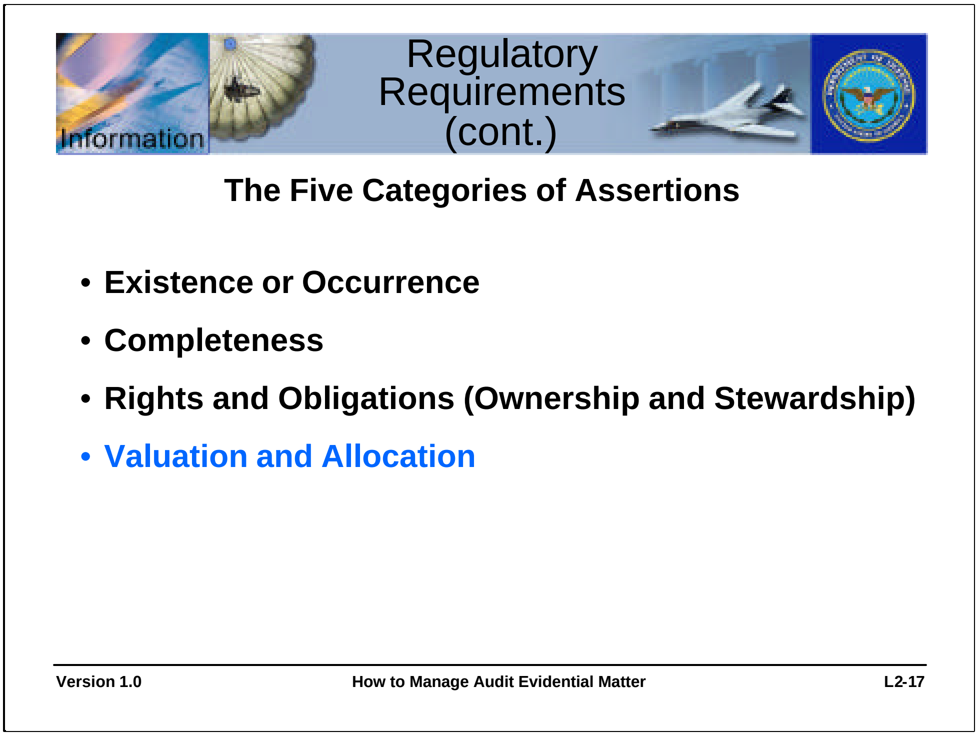
The Five Categories of Assertions

- Existence or Occurrence
- Completeness
- Rights and Obligations (Ownership and Stewardship)

An assertion made by management about rights and obligations addresses whether assets are the rights of the Department and the liabilities are the obligations of the Department at a given date.

For example, the Department asserts that amounts capitalized for PP&E in the Balance Sheet represent the cost of the entity’s rights to the PP&E and that the corresponding leased property liability represents the obligation of the entity.

Let’s discuss the category valuation and allocation.


Information

Regulatory Requirements (cont.)

The Five Categories of Assertions

- **Existence or Occurrence**
- **Completeness**
- **Rights and Obligations (Ownership and Stewardship)**
- **Valuation and Allocation**

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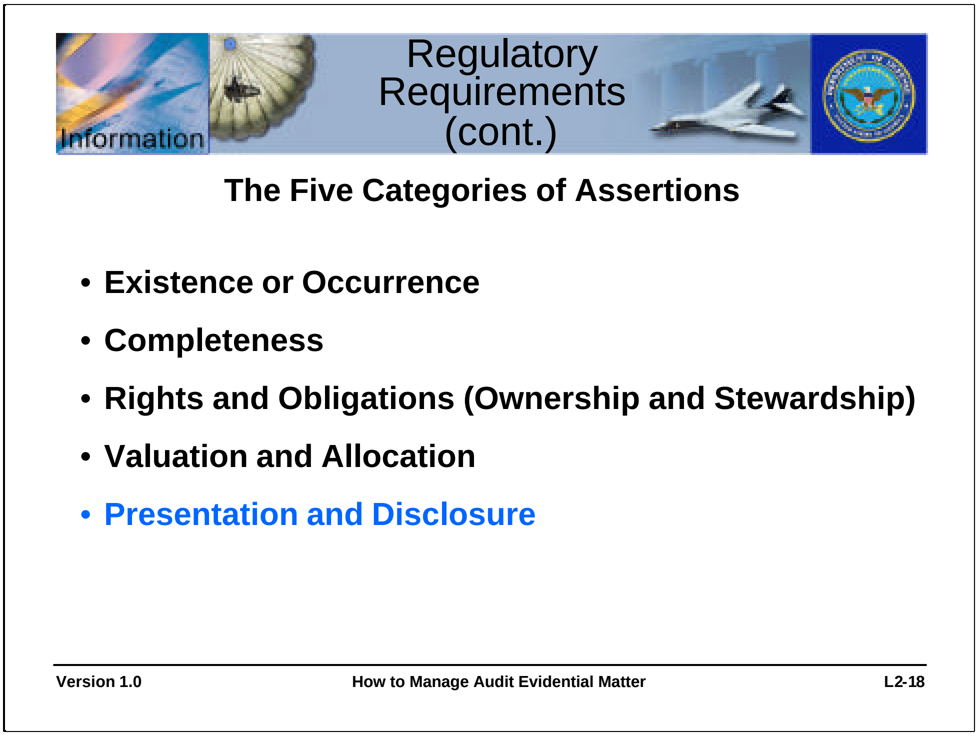
An assertion made by management about valuation and allocation addresses whether the assets, liabilities, equity, revenues, and expenses have all been included in the financial statements at the appropriate amounts.

For example, the Department asserts that the PP&E is recorded at historical costs and that costs are systematically allocated to the appropriate accounting periods. The auditor ensures that the property was valued correctly and that the amount was authorized. In addition, the Department asserts that Accounts Receivable shown on the Balance Sheet is stated at its net realizable value.

Let’s discuss the last category presentation and disclosure.


Information

Regulatory Requirements (cont.)

The Five Categories of Assertions

- **Existence or Occurrence**
- **Completeness**
- **Rights and Obligations (Ownership and Stewardship)**
- **Valuation and Allocation**
- **Presentation and Disclosure**

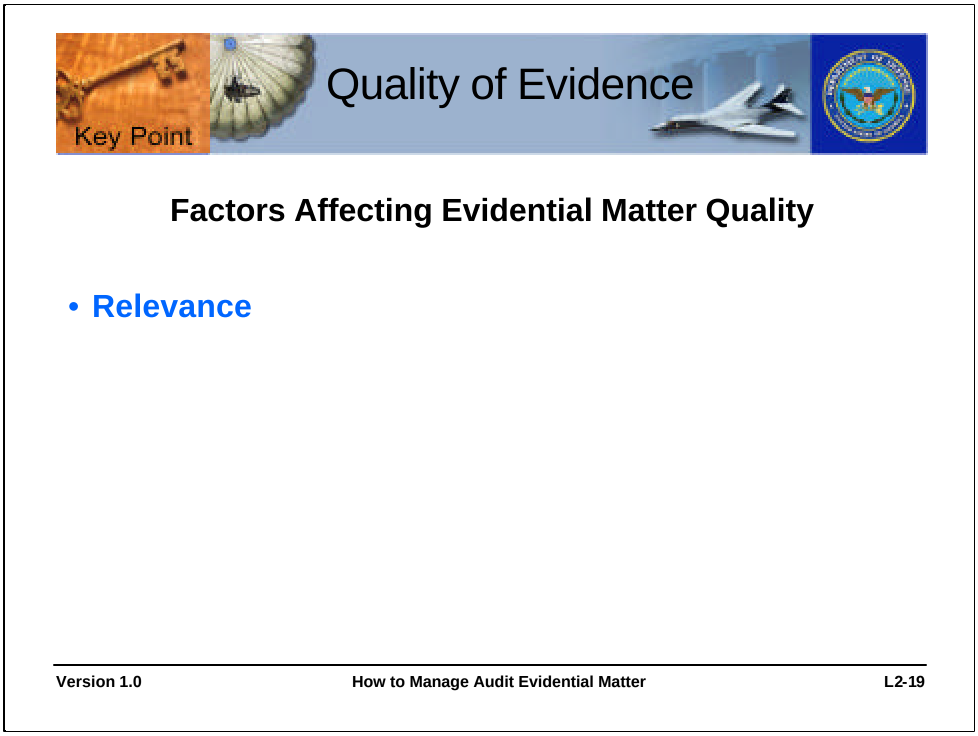
An assertion made by management about presentation and disclosure addresses whether particular components of the financial statements are properly classified, described, and disclosed.

For example, the Department asserts that the amount presented in their financial statement includes a building for which they are the preponderant user.

All of the five categories are important. From the Department's assertions, the auditor develops audit objectives and designs substantive tests.

We have discussed evidential matter, its importance, retention, audit trails, and the categories and examples of assertions.

Now let's discuss the factors that affect the quality of evidential matter.



Key Point

Quality of Evidence

Factors Affecting Evidential Matter Quality

- **Relevance**

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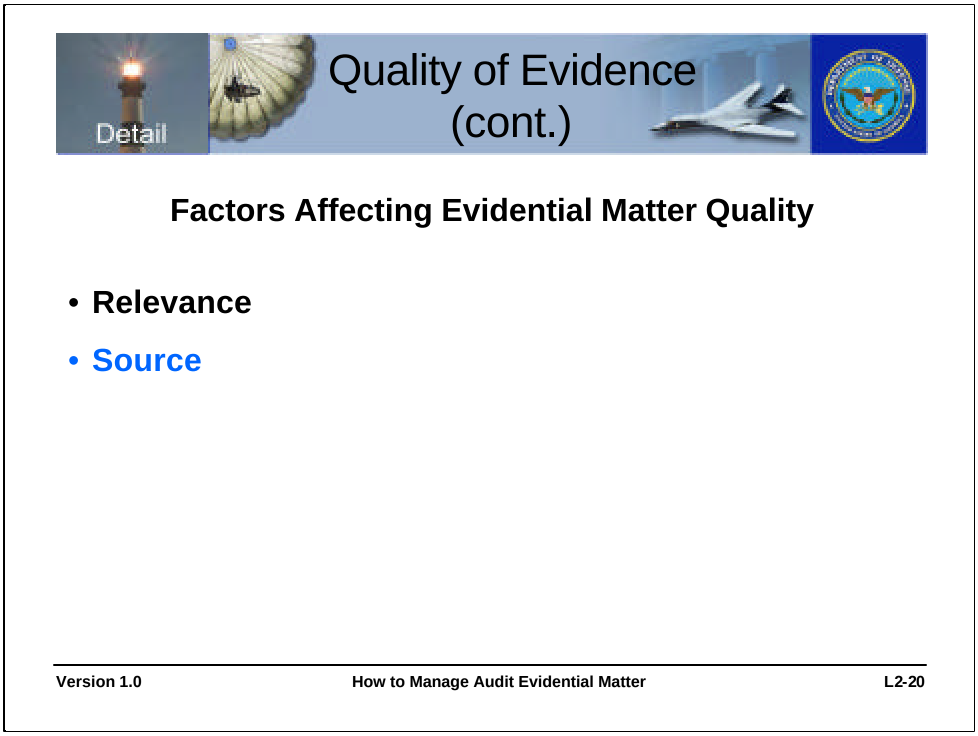
The quality of evidence is directly related to the internal controls that are applied to the underlying accounting data and the corroborating information. Strong internal control enhances the quality of evidence while weak internal control does not prevent or detect errors and irregularities in an accounting process. The quality of corroborating information depends on the relevance, source, timeliness, and objectivity of the evidential matter. Let’s discuss each of these items with respect to the quality of evidence.

The factor of relevance means that the evidentiary matter must be pertinent to the auditors objective. An example of this would be an auditor examining the manner in which an agency performed a physical inventory at the installation level for equipment as opposed to office supplies. Equipment inventory performance is very relevant to the auditor as the nature of the equipment usage is long term and the value, substantial. Controls must be in place for it’s security, maintenance and management. In contrast, physical inventories of office material are far less relevant as they have a short life span and are relatively low in value.

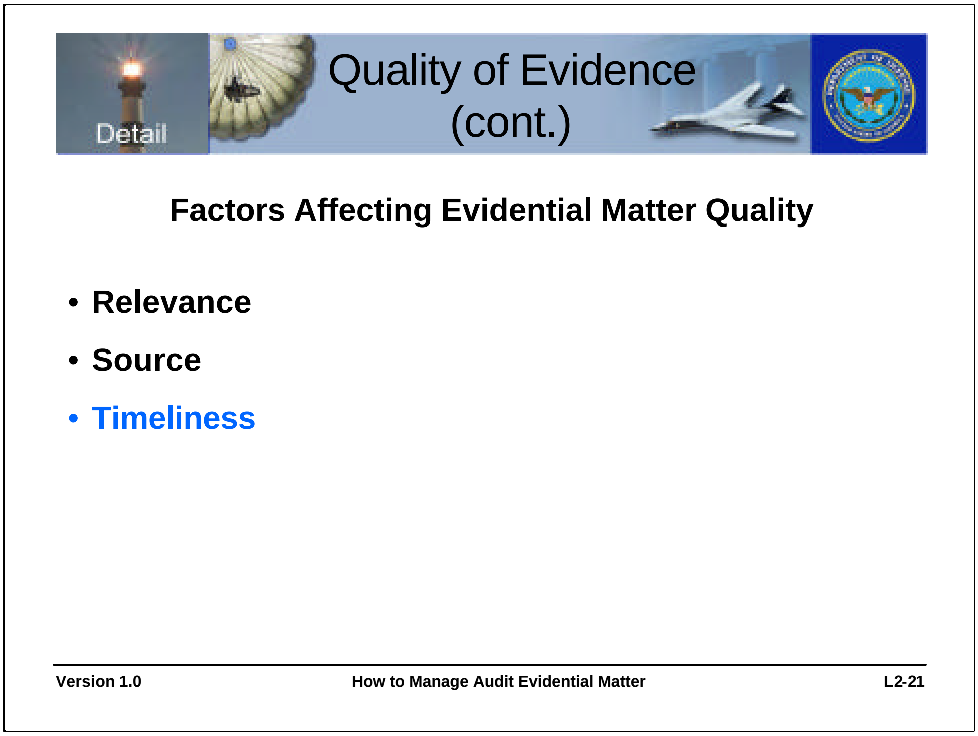


Quality of Evidence (cont.)

Factors Affecting Evidential Matter Quality

- **Relevance**
- **Source**

The factor of source refers to where the documentation is obtained. Let’s apply the factor of source through an example. If the original documents are not available, the auditor would assign a lower quality of evidence to e-mails documenting shipping orders and sales invoices from the files of the agency being audited to verify balances, as opposed to communicating directly with the vendor or Defense Contract Audit Agency (DCAA), to obtain balance information. Auditors view the vendor and DCAA as independent third parties providing more quality data.



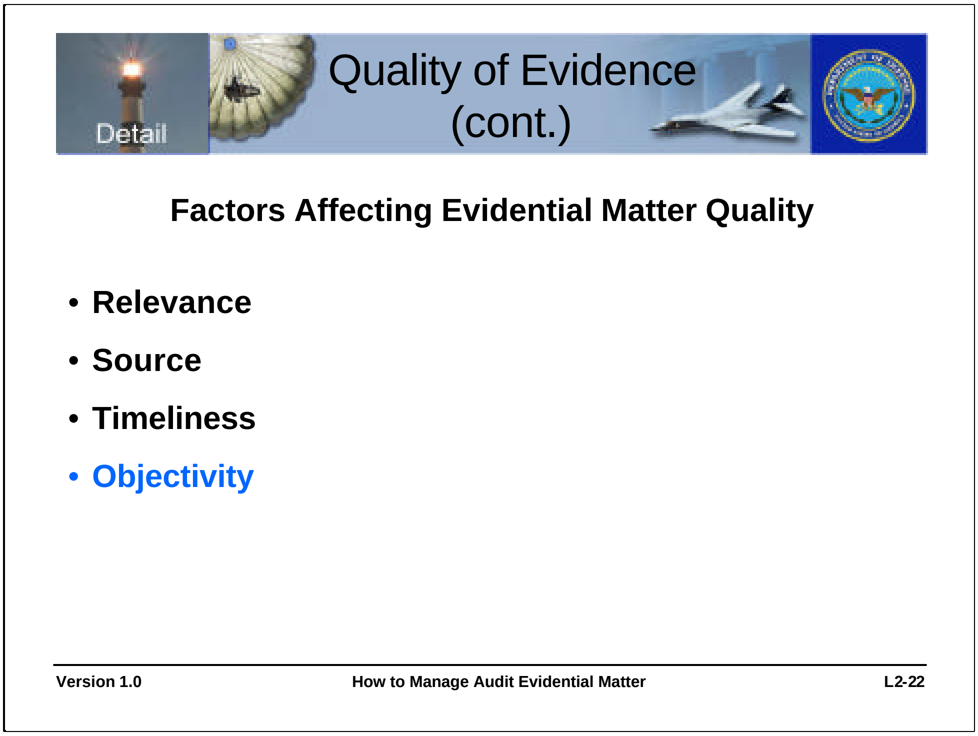
Quality of Evidence (cont.)

Factors Affecting Evidential Matter Quality

- **Relevance**
- **Source**
- **Timeliness**

Version 1.0 How to Manage Audit Evidential Matter L2-21

The factor of timeliness refers to the time sensitive nature of processing transactions. Examples of timeliness are promptly posting transactions and properly cutting off cash, sales, and purchase transactions at the statement date. This task is facilitated when audit procedures are applied at or near the statement date. Evidence obtained from physical counts at the statement date provide better evidence of quantities on hand than counts made at other times.



Detail

Quality of Evidence (cont.)

Factors Affecting Evidential Matter Quality

- **Relevance**
- **Source**
- **Timeliness**
- **Objectivity**

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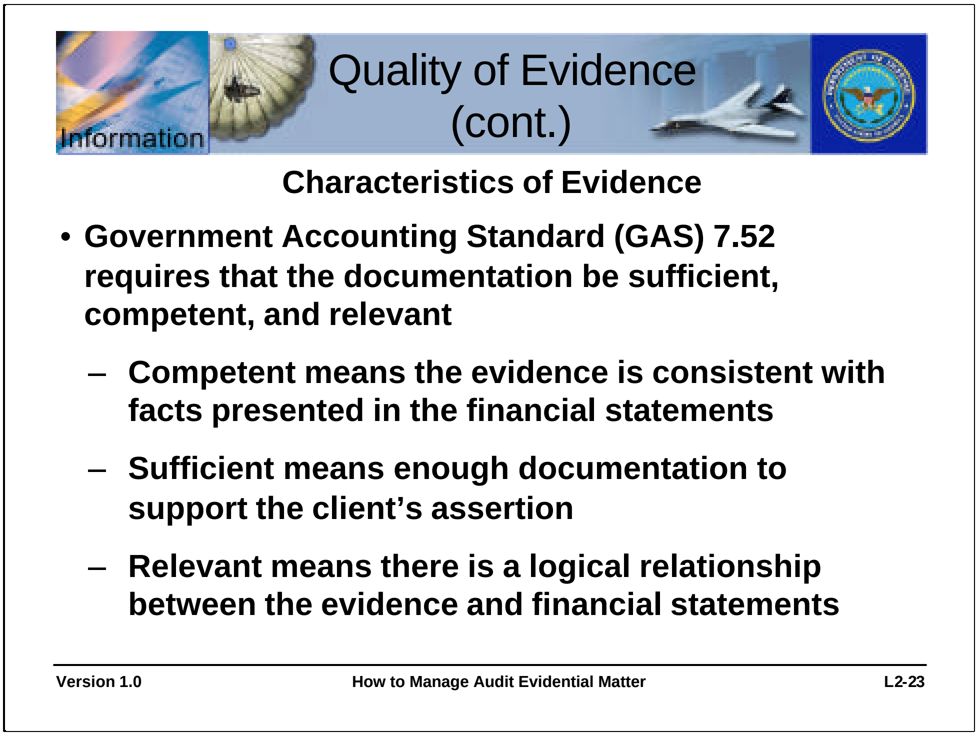
Objective evidence is more reliable than evidence that is subjective. For example, tangible assets that have been verified through physical inspection provide objective evidence of their existence. Evidence obtained from outside sources is also more objective than evidence provided solely by the auditee.

Also consider that some evidence must be subjective. An example of subjective evidence is the estimates on inventory obsolescence. The quality of this subjective evidence would largely depend on the qualifications of the individual making the estimate and the confidence level that it provides to the auditor. Another consideration is the credibility of the decision making process applied to determine the obsolescence.

Now that we've explored how to evaluate the quality of evidence, let's look at characteristics of evidence.


Information

Quality of Evidence (cont.)

Characteristics of Evidence

- **Government Accounting Standard (GAS) 7.52 requires that the documentation be sufficient, competent, and relevant**
  - **Competent means the evidence is consistent with facts presented in the financial statements**
  - **Sufficient means enough documentation to support the client's assertion**
  - **Relevant means there is a logical relationship between the evidence and financial statements**

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Evidential matter requires that sufficient competent evidence be obtained through inspection, observation, inquiries, and confirmations to afford reasonable basis for an opinion regarding the financial statements being audited.

Competent forms of evidence are:

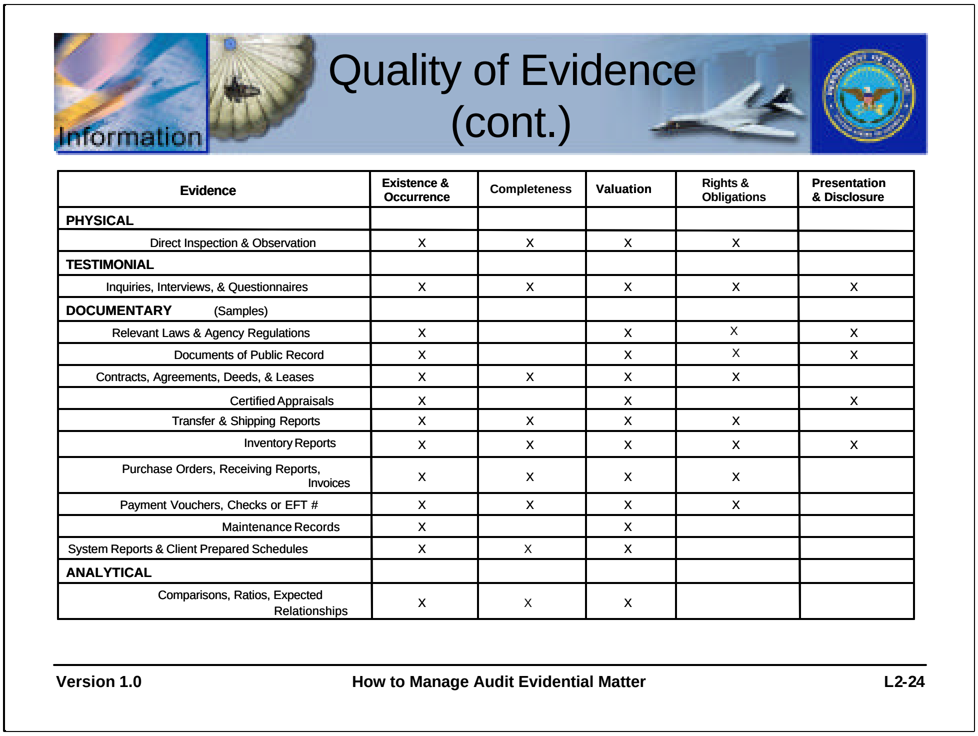
- obtained from credible sources
- developed under an effective system of management controls
- based on original documents.

Less competent forms of evidence are:

- e-mail (unless it can be corroborated)
- unvalidated computer-processed data.

Internal control plays a major role in the acceptance of evidential matter. The more effective the internal control, the more assurance it provides about the reliability of the accounting data and financial statements. The auditor has to rely on evidence that is persuasive, rather than convincing.

Let's now examine how various types of documentation can meet the categories of assertions.

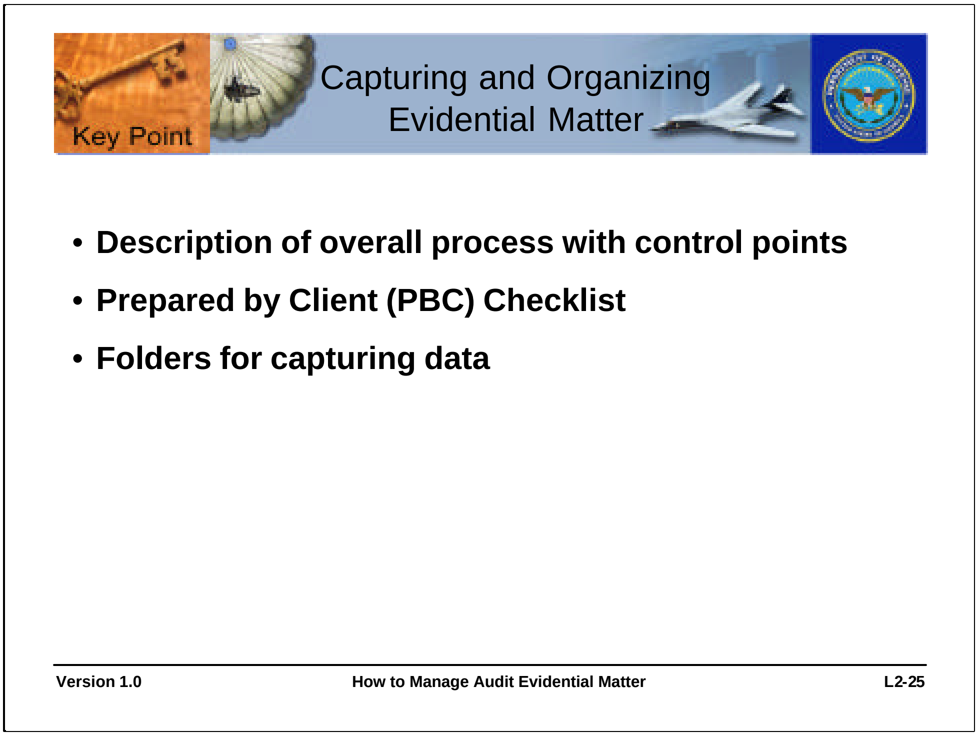


Information

Quality of Evidence (cont.)

Evidence	Existence & Occurrence	Completeness	Valuation	Rights & Obligations	Presentation & Disclosure
PHYSICAL					
Direct Inspection & Observation	X	X	X	X	
TESTIMONIAL					
Inquiries, Interviews, & Questionnaires	X	X	X	X	X
DOCUMENTARY (Samples)					
Relevant Laws & Agency Regulations	X		X	X	X
Documents of Public Record	X		X	X	X
Contracts, Agreements, Deeds, & Leases	X	X	X	X	
Certified Appraisals	X		X		X
Transfer & Shipping Reports	X	X	X	X	
Inventory Reports	X	X	X	X	X
Purchase Orders, Receiving Reports, Invoices	X	X	X	X	
Payment Vouchers, Checks or EFT #	X	X	X	X	
Maintenance Records	X		X		
System Reports & Client Prepared Schedules	X	X	X		
ANALYTICAL					
Comparisons, Ratios, Expected Relationships	X	X	X		

This slide provides examples as to what category of assertions can be met by various types of evidence.

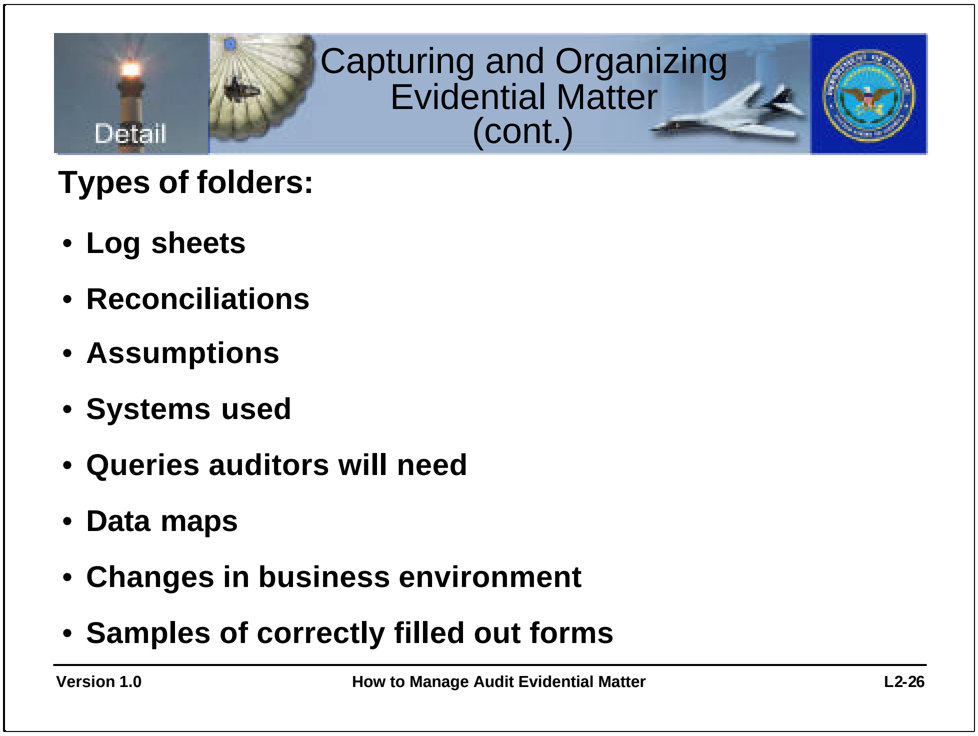


Capturing and Organizing Evidential Matter

- **Description of overall process with control points**
- **Prepared by Client (PBC) Checklist**
- **Folders for capturing data**

In order to prepare successfully to support a financial audit, you must organize your evidential matter throughout the year. You develop a system of folders. You create a folder that includes a description of the overall process of your organization with processing control points. These processing control points are the field sites that do your accounting, the centers that consolidate your financial statements for U.S. Treasury reporting, or the inventory control points that support your installation with supplies. A PBC checklist from a previous audit helps you understand auditor requirements and focus areas. You use it to anticipate future requests. The PBC will be explained in Lesson 3.

Let’s look at various types of folders to capture and maintain evidential matter.



Capturing and Organizing Evidential Matter (cont.)

Types of folders:

- **Log sheets**
- **Reconciliations**
- **Assumptions**
- **Systems used**
- **Queries auditors will need**
- **Data maps**
- **Changes in business environment**
- **Samples of correctly filled out forms**

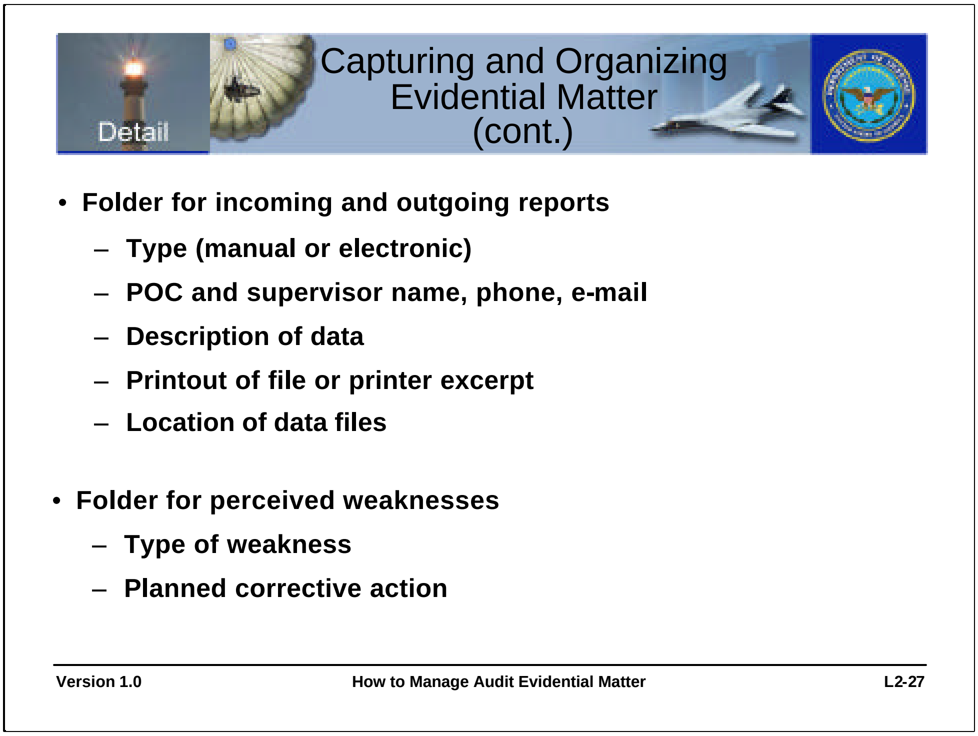
Version 1.0 How to Manage Audit Evidential Matter L2-26

You collect log sheets that contain the time tables that your feeder systems use to process subsidiary data to your primary accounting system. For example, you have a log sheet documenting the receipt of goods by your stockroom.

Based on past audits you created separate folders that contain assumptions. You know that unless something dramatically happens to your business it should continue to operate much the same as it was in the past. However, if processes have changed, you may want to reflect this information and document these events as a tool for future decision making and auditor review.

You create a folder to document your systems. This folder contains the name of the system and queries that the auditors need to extract certain data to complete their audit. To show how manually developed data is derived for system input, you must create a map of the manual process.

Additional folders for your consideration are those that maintain changes to the business environment or contain correctly completed forms used by the entity.



Capturing and Organizing Evidential Matter (cont.)

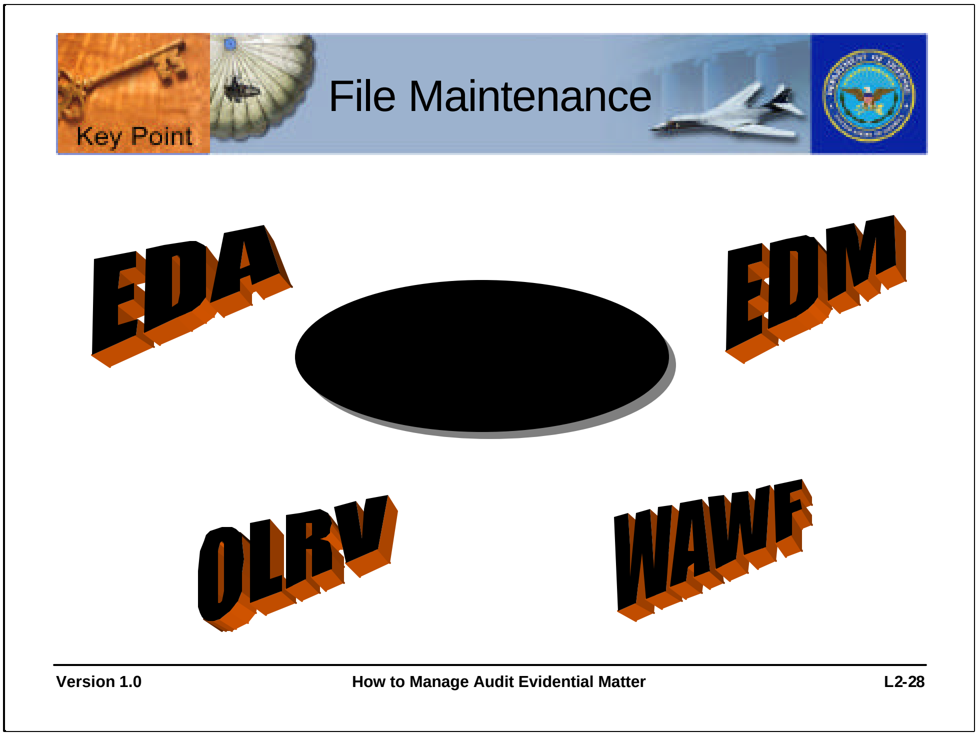
- **Folder for incoming and outgoing reports**
  - **Type (manual or electronic)**
  - **POC and supervisor name, phone, e-mail**
  - **Description of data**
  - **Printout of file or printer excerpt**
  - **Location of data files**

- **Folder for perceived weaknesses**
  - **Type of weakness**
  - **Planned corrective action**

You create a folder for incoming and outgoing reports that you know are integral to your processes. These reports may be manual or electronic. The auditor may need to know this as it may affect his comfort level as to the reliability of the report. The report includes a Point Of Contact (POC) and supervisor name, phone number, and e-mail. Provide a description of the report's content. Maintain folders that document the impact on the Fund Balance with Treasury (FBWT) account. Print the report in total or just appropriate excerpts.

You create a final folder to document what you perceive as audit weaknesses. These may be weaknesses that were cited on the last audit or those that were recognized from subsequent internal control reviews. It is always better to show the auditor that you identified the weakness and that you have a plan for corrective action.

Now that you have captured your audit information, lets look at a specific example of a Vendor Pay transaction. As we explain the Vendor Pay process, think about how the maintenance of evidential matter by each individual organization POC assists better business practices and the auditors' ability to express an unqualified opinion.



Key Point

File Maintenance

EDA

EDM

OLRV

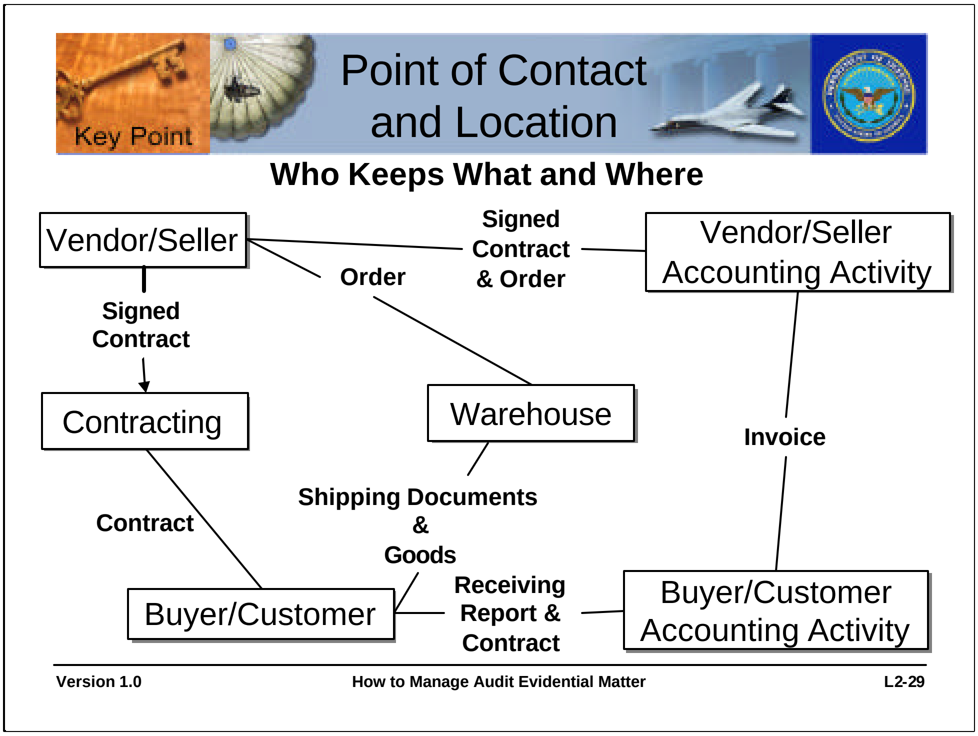
WAWF

Version 1.0 How to Manage Audit Evidential Matter L2-28

Maintenance or availability of supporting documentation doesn't mean that there has to be a hard copy to support a transaction. Software such as Electronic Document Access (EDA), Electronic Document Management (EDM), On Line Report View (OLRV), and Wide Area Workflow (WAWF) is used to retain electronic copies of supporting documents and to expedite research through query tools.

These tools provide management and auditors with a better view of business operations by providing forms and reports of record retention, and retrieval.

Let's look at who is responsible for retaining various types of evidential matter.



Key Point

Point of Contact and Location

Who Keeps What and Where

Vendor/Seller

Signed Contract

Contracting

Contract

Buyer/Customer

Order

Warehouse

Shipping Documents & Goods

Signed Contract & Order

Vendor/Seller Accounting Activity

Invoice

Receiving Report & Contract

Buyer/Customer Accounting Activity

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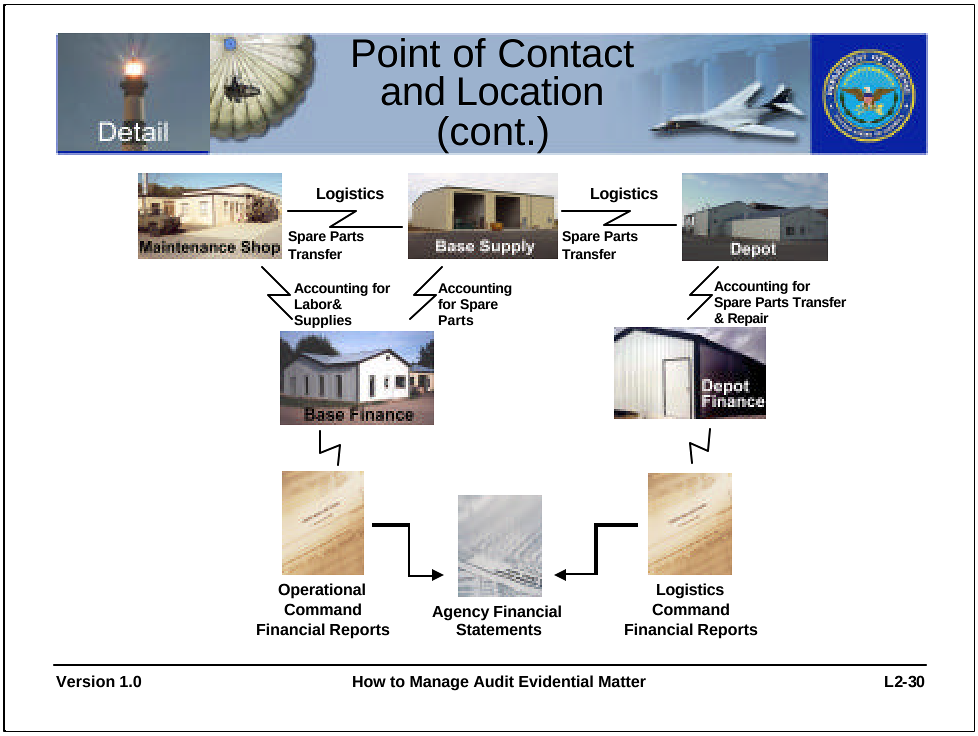
Each organization in this flow chart has a POC who is responsible for the retention of evidential matter that supports the underlying accounting data for the function they support. The auditors need to know where to go to verify the transaction. Let’s consider a purchase of supplies from a vendor. In order to make a payment the Vendor Pay staff must have a contract, invoice, and receiving report. In this flow diagram you see that the auditors (auditing the buyer) must verify the contract with contracting, the invoice with the seller’s accounting activity, and the receiving report with the buyer’s receiving and accounting activities. Shipping documents can be verified at the warehouse since they are issued with the goods to the customer. Flowcharting all processes enhances your staffs understanding of your operation and the auditors’ ability to work the process to satisfy their need for evidential matter. The auditors look to the most reliable source to verify information.

Where is evidential matter kept?

For each organization represented in this chart, there will be a POC who provides assistance to the auditors in the identification and retrieval of evidential matter. For this reason, it is important that in managing evidential matter for the preparation of an audit, the POCs’ network is well informed and part of the audit preparation effort. The POCs at each individual location need to understand their role.



Point of Contact and Location (cont.)

Maintenance Shop

Logistics

Spare Parts Transfer

Base Supply

Logistics

Spare Parts Transfer

Depot

Accounting for Labor& Supplies

Accounting for Spare Parts

Accounting for Spare Parts Transfer & Repair

Base Finance

Depot Finance

Operational Command Financial Reports

Agency Financial Statements

Logistics Command Financial Reports

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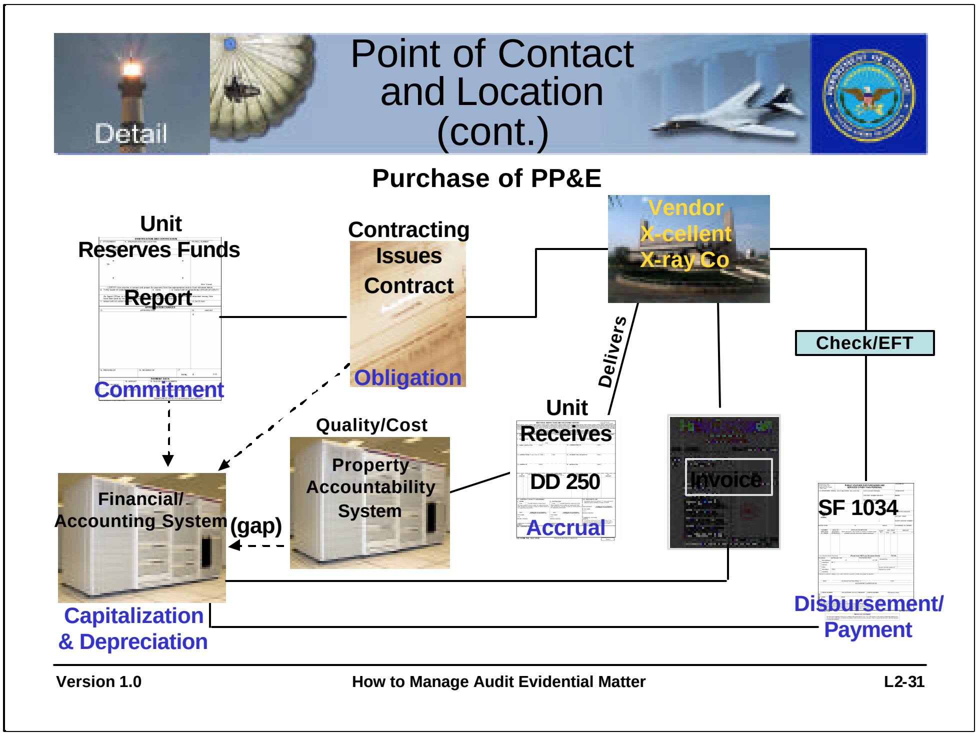
In this example, Base Supply accepted a damaged item from the Maintenance Shop. Base Supply issued a replacement item back to the Maintenance Shop. Base Supply shipped the damaged item to the Depot for repair.

Sources of input into financial management systems are generally made through various service-specific feeder systems. Logistics feeder systems moved the issued replacement item to the Depot for repair. Base Finance made the accounting entries into the accounting system for the issuance of the replacement item, acceptance of the damaged item, and valuation of the damaged item based on the expected cost of repair and wrote off the loss. Depot Finance accounted for the transfer of the item back to Base Supply and acceptance of the replacement item. Their accounting systems produced financial statements. Financial reports from the logistics and operation command were rolled up into the agencies' financial statements. From this graphic you see the effect that a transaction has on the financial statements and retention of evidential matter at the lower levels of the organization.

Every day, a document representing a transaction passes our desks. That document is either a sole source of the input or a supporting document for the input. Supporting document information may have to be compiled into a spreadsheet or another feeder system before entering the accounting system.

There are different types of source documents such as funding documents, work orders, purchase requests, receiving reports, and disbursement forms at various locations in the organization that provide more detail on the transaction. All personnel should be aware of their location in support of audits.



Detail

Point of Contact and Location (cont.)

Purchase of PP&E

Unit Reserves Funds

Report

Commitment

Contracting Issues Contract

Obligation

Vendor X-cellent X-ray Co

Delivers

Check/EFT

Quality/Cost

Unit Receives

DD 250

Accrual

Invoice

SF 1034

Disbursement/ Payment

Financial/ Accounting System

(gap)

Property Accountability System

Capitalization & Depreciation

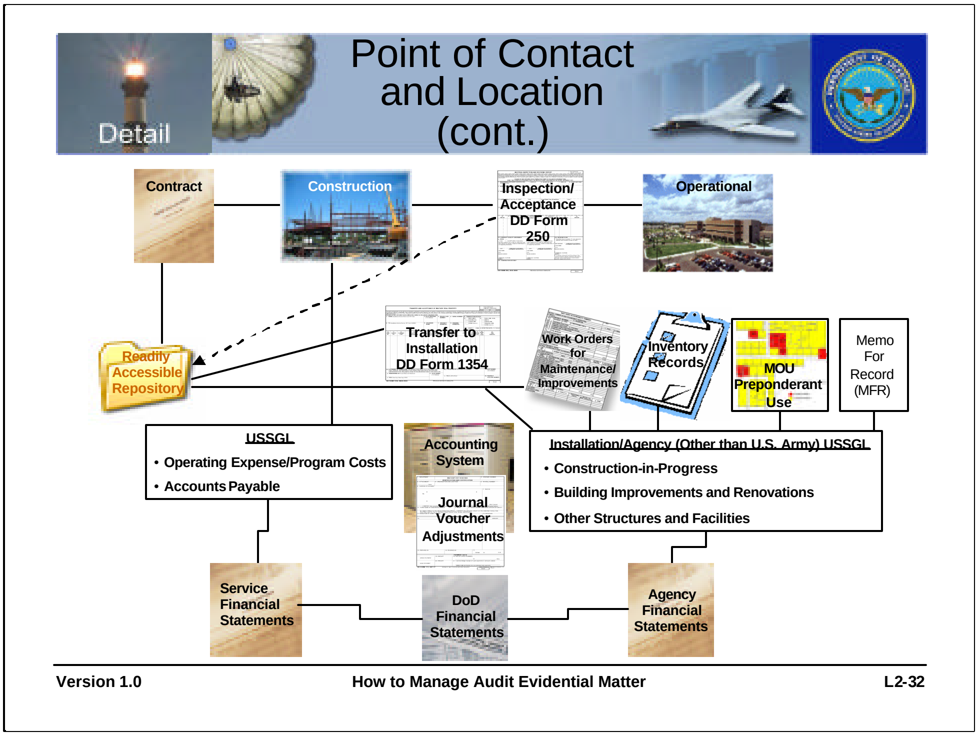
There are different types of source documents, such as purchase requests, purchase orders, receiving reports, and disbursement forms, that provide transaction details.

Let's say that your activity receives mission funds to purchase PP&E. At the appropriate time, funds are reserved for the purchase of PP&E, a commitment is established, and a unique document number created. Once the contract is approved and issued, it creates an obligation with the same document number. The obligation is recorded based on the contract. Once the PP&E is received, a receiving document is prepared and the item recorded in the property accountability accounting systems. Upon receipt of the invoice, a payment is processed based on the contract, invoice, and receiving report.

If the PP&E purchase is $100,000 or more, it is capitalized (since it equals or exceeds the DoD threshold of $100,000) and depreciated based on the guidance in the DoDFMR. The PP&E is recorded in the appropriate accounting and/or property accountability system. You can see that in each step, a different document is created.

To recap an audit trail: a unique document number is established and can be tracked from its inception to the final disbursement. The PP&E is traceable to the appropriate property accountability system. The financial information is traceable also.

Let's look at the importance and benefit of maintaining evidential matter.



Detail

Point of Contact and Location (cont.)

Contract

Construction

Inspection/ Acceptance DD Form 250

Operational

Readily Accessible Repository

Transfer to Installation DD Form 1354

Work Orders for Maintenance/ Improvements

Inventory Records

MOU Preponderant Use

Memo For Record (MFR)

USSGL
- Operating Expense/Program Costs
- Accounts Payable

Accounting System

Journal Voucher Adjustments

Installation/Agency (Other than U.S. Army) USSGL
- Construction-in-Progress
- Building Improvements and Renovations
- Other Structures and Facilities

Service Financial Statements

DoD Financial Statements

Agency Financial Statements

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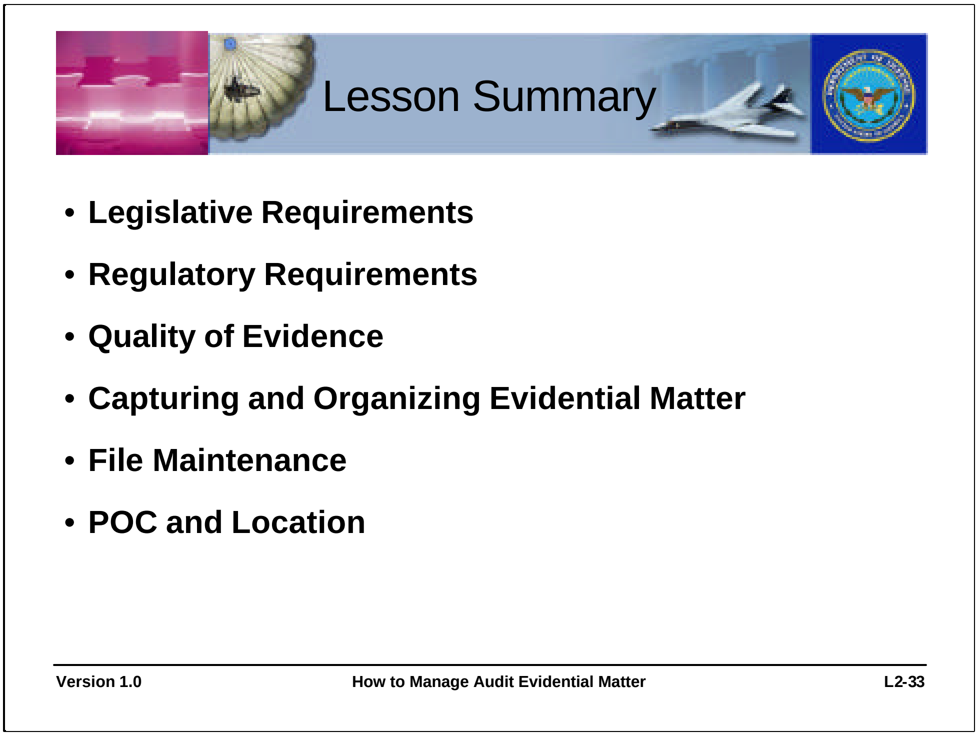
In examining the effect of a transaction and its related documentation and general ledger entries on the agency's financial statements, let's use the example of a construction project initially managed by the U.S. Army Corps of Engineers at a Military installation other than Army.

This diagram depicts various interrelationships involved in developing and subsequently placing the building into operations. Each of these events require appropriate documentation to support the accounting transactions recorded in the general ledgers of the appropriate entity. It shows the capturing of the data at various levels, until the information is summarized in the department's financial statements. Data captured at various levels is summarized into the Department's financial statements.

Let's summarize the lesson.



Lesson Summary

- **Legislative Requirements**
- **Regulatory Requirements**
- **Quality of Evidence**
- **Capturing and Organizing Evidential Matter**
- **File Maintenance**
- **POC and Location**

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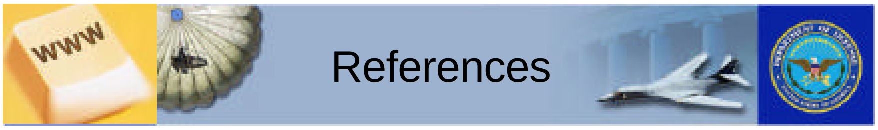
In this lesson, you learned that the National Archives and Record Administrative Act gave the authority to NARA to develop guidelines for record retention. These guidelines are translated to the regulations of the DoD, agencies, and installations. You learned how the FAM Checklist is used to identify documentation requirements in support of day-to-day operations and financial statements. You also learned the factors of relevance, source, timeliness, and objectivity that auditors use to determine the competency and quality of evidential matter.

Underlying accounting data includes books of original entry (general journal), general and subsidiary ledgers, related accounting manuals, and informal and memorandum records such as worksheets, supporting cost allocations, computations, and reconciliations. Corroborating evidence is the supporting documentation that is the basis for transactions being recorded in the journals and ledgers such as contracts or receiving reports.

Documentation should be readily available and accessible to auditors. This will minimize the amount of time and expense for auditors and audit liaisons.

You reviewed the system of folders for the collection and retention of audit sensitive data. The importance of the POC operating at the individual locations was described with relation to various types of transactions.

The following slide lists references available for additional information.



References

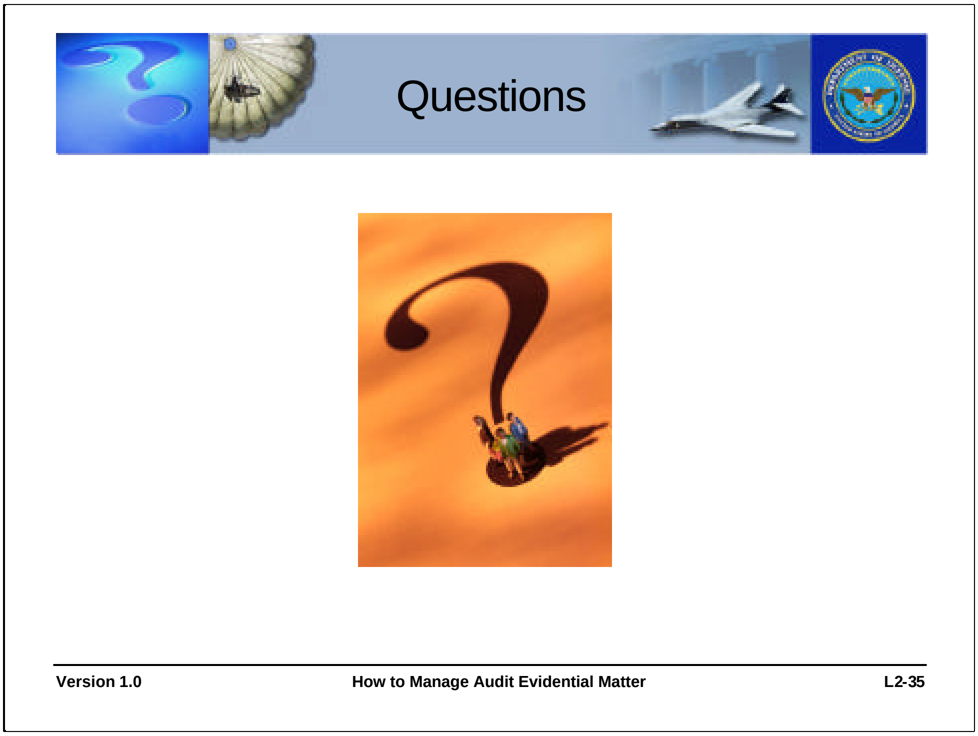
DoDFMR: http://www.dod.mil/comptroller/fmr/

DFAS-IN 37-1:
https://dfas4dod.dfas.mil/centers/dfasin/library/ar37-1/index.htm

DFAS-DE 7010.1: https://www.afbudsys.disa.mil/afdd.htm

NARA:
http://www.archives.gov/welcome/print_friendly.html?page=index_content.html&title=N

FAM: http://www.gao.gov/special.pubs/gaopcie/



Questions

Version 1.0 How to Manage Audit Evidential Matter L2-35

Do you have any questions on the material covered in this lesson?

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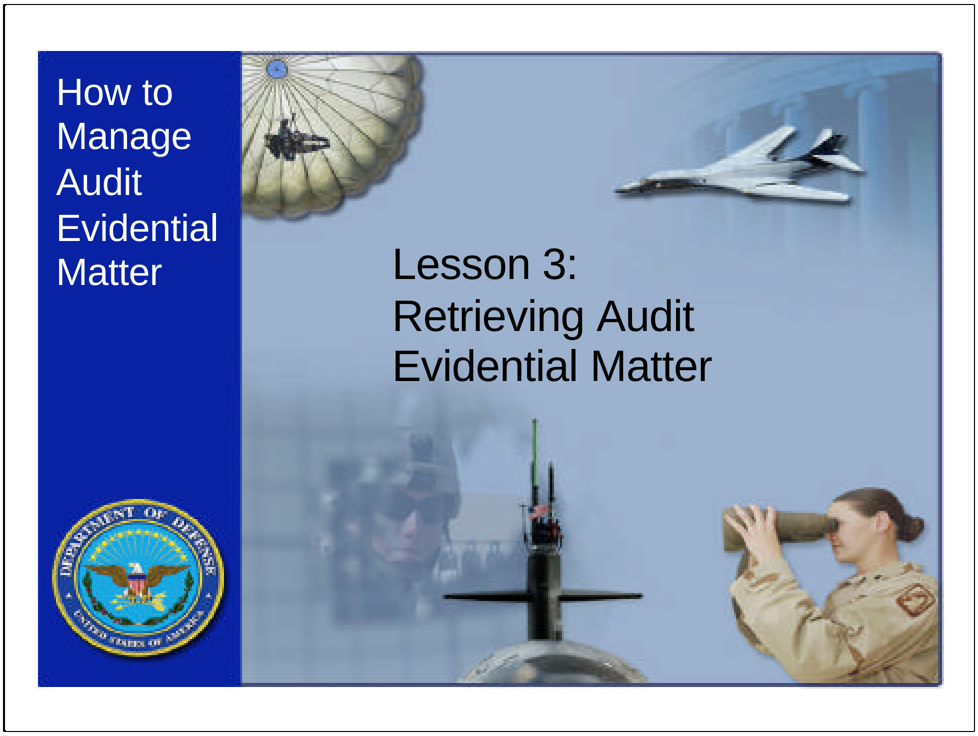
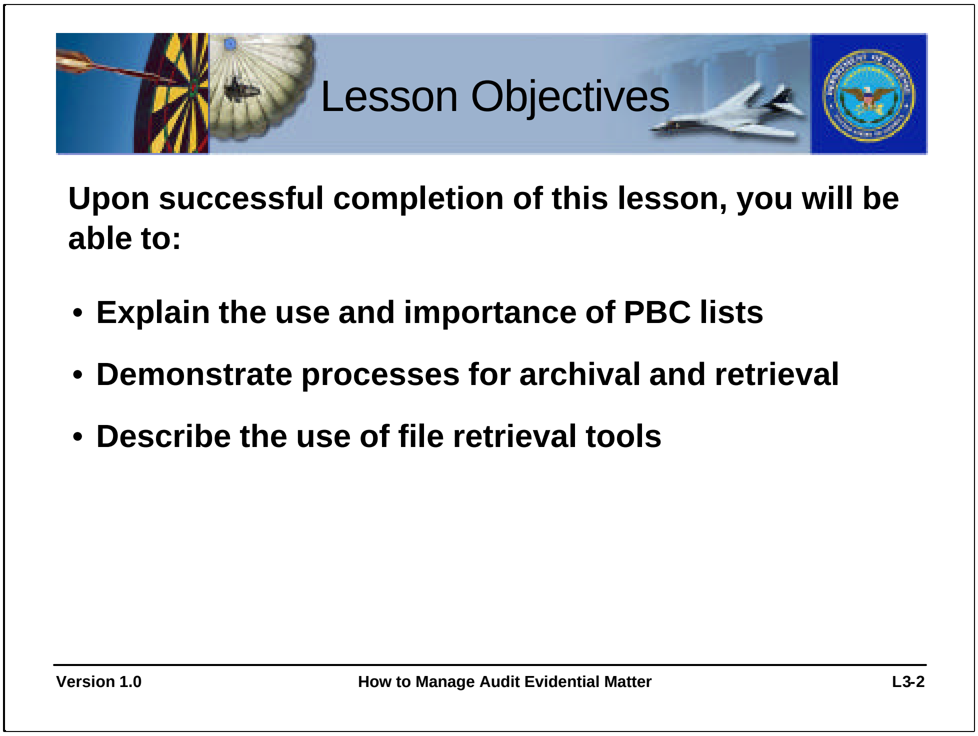


How to Manage Audit Evidential Matter

Lesson 3: Retrieving Audit Evidential Matter

In Lesson 3, we explore the methods used to retrieve audit evidential matter.



Lesson Objectives

Upon successful completion of this lesson, you will be able to:

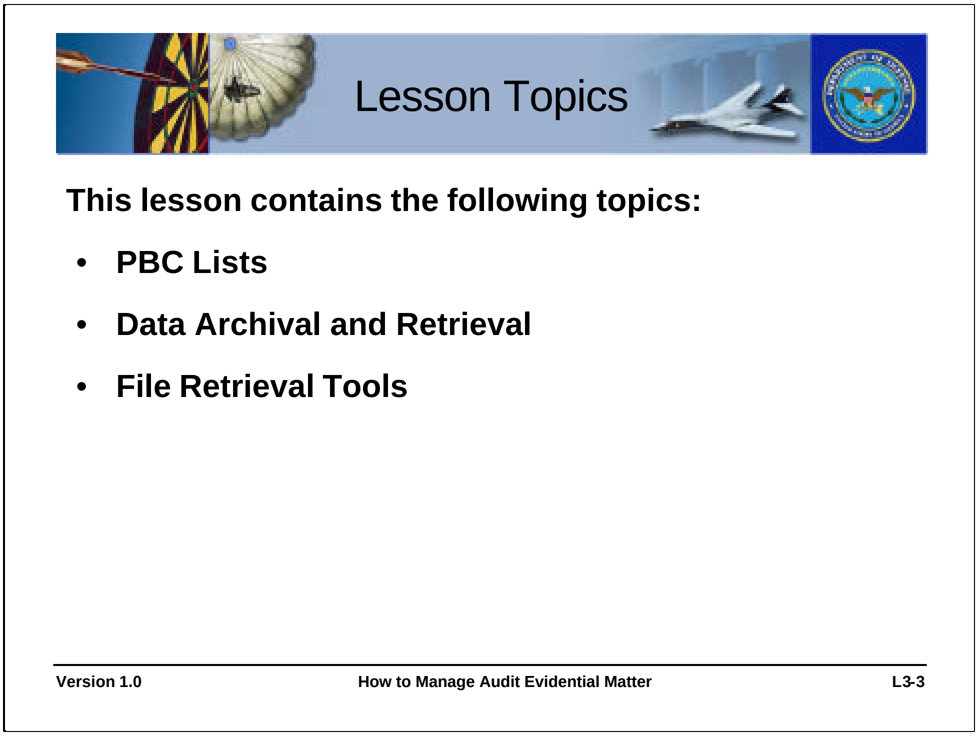
- **Explain the use and importance of PBC lists**
- **Demonstrate processes for archival and retrieval**
- **Describe the use of file retrieval tools**

In order to retrieve audit evidential matter, you must first understand the use and importance of the PBC list. PBC lists are lists of items requested by the auditor.

Throughout the year, documents that support the Department’s operations and transactions are processed. They must be archived in such a way that the information is uncorrupted and accessible for retrieval. We will discuss the processes for archival and retrieval.

Processes for archival and retrieval use various tools. You will be able to describe these tools and their uses in the retrieval of audit evidential matter.

Let’s look at the topics discussed in this lesson.



Lesson Topics

This lesson contains the following topics:

- **PBC Lists**
- **Data Archival and Retrieval**
- **File Retrieval Tools**

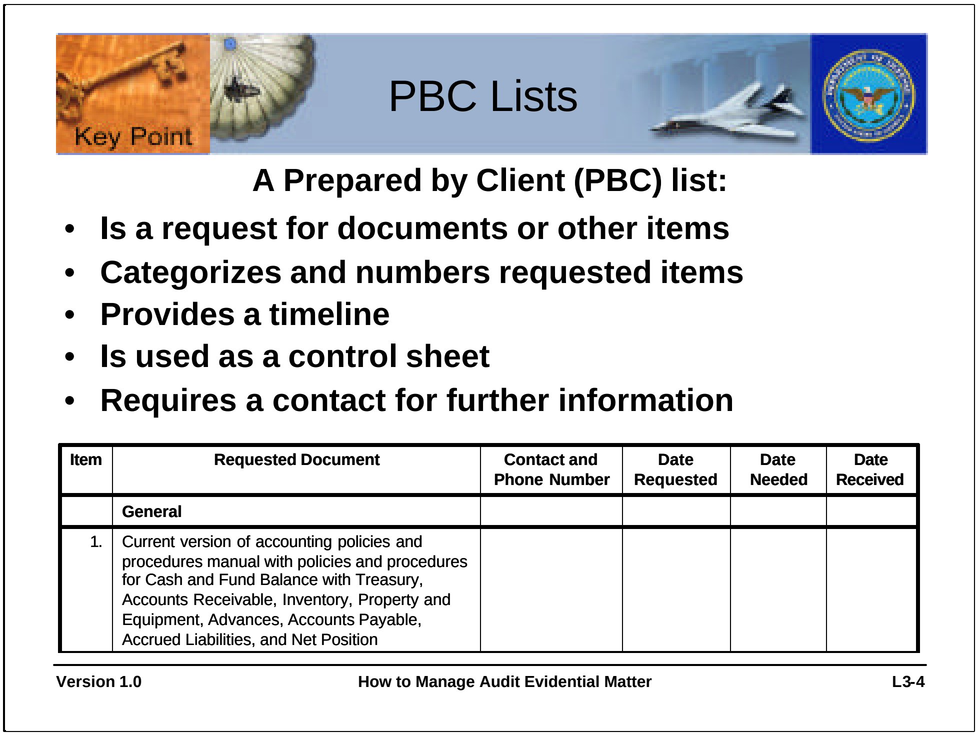
This lesson contains the following topics: PBC Lists, Data Archival and Retrieval, and File Retrieval Tools.

We will discuss what PBC Lists are, describe their purpose, and demonstrate their importance.

We will also discuss data archival and retrieval including data accessibility, how the appropriate POC and location adds to the ability to retrieve data, and the responsibility of the POC for data archival and retrieval.

Then we will examine the uses of file retrieval tools such as EDA, EDM, and OLRV.

Let’s begin with PBC lists.



PBC Lists

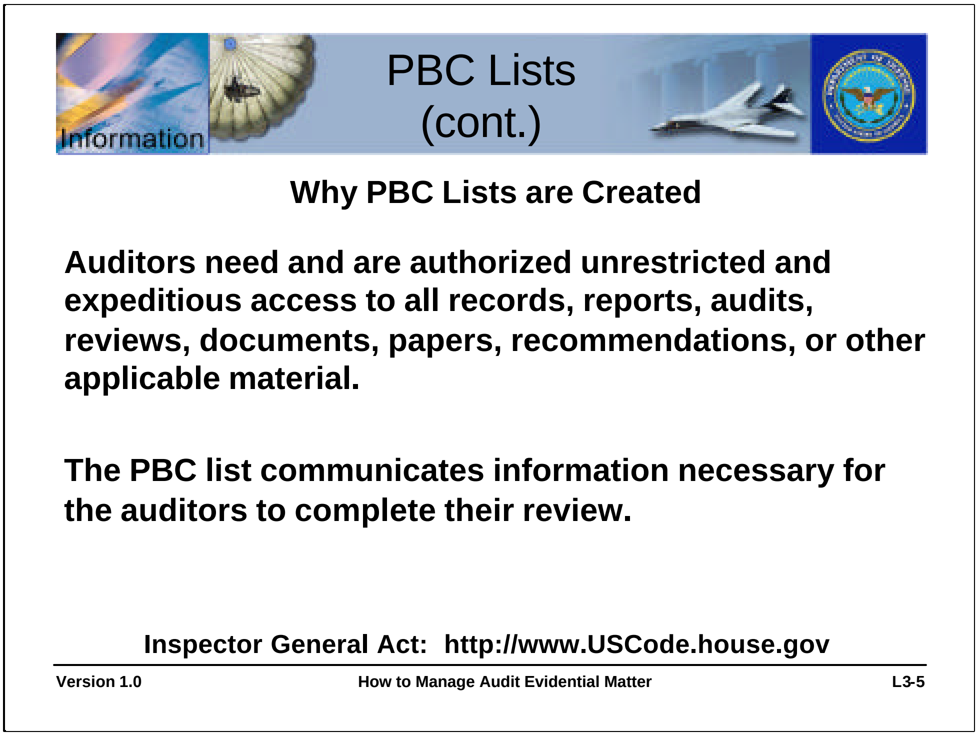
A Prepared by Client (PBC) list:

- **Is a request for documents or other items**
- **Categorizes and numbers requested items**
- **Provides a timeline**
- **Is used as a control sheet**
- **Requires a contact for further information**

Item	Requested Document	Contact and Phone Number	Date Requested	Date Needed	Date Received
	General				
1.	Current version of accounting policies and procedures manual with policies and procedures for Cash and Fund Balance with Treasury, Accounts Receivable, Inventory, Property and Equipment, Advances, Accounts Payable, Accrued Liabilities, and Net Position				

Once an audit contract is awarded to an Independent Public Accountant (IPA), a representative of the accounting firm will provide your entity with a PBC list either prior to or at the entrance conference for the audit. This list is a checklist of requested documents or other deliverable items broken down into several categories and numbered for ease of reference. These items are required by the auditors to enable them to adequately audit your organization.

The PBC list provides a timeline and control sheet on the receipt of the requested information. Once completed, the PBC list also serves as a resource for the audit team to determine who they can obtain further information from concerning the requested items.


Information

PBC Lists (cont.)

Why PBC Lists are Created

Auditors need and are authorized unrestricted and expeditious access to all records, reports, audits, reviews, documents, papers, recommendations, or other applicable material.

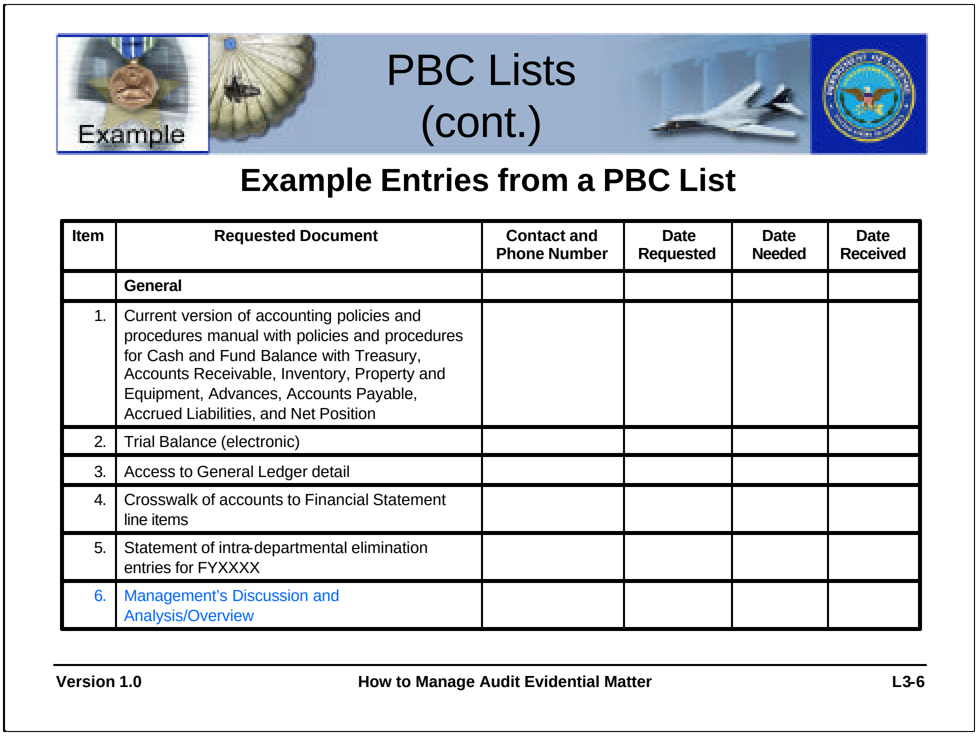
The PBC list communicates information necessary for the auditors to complete their review.

Inspector General Act: http://www.USCode.house.gov

Financial statement auditors (service auditors, IPAs, and/or Department of Defense Inspector General (DoD OIG) auditors) need unrestricted and expeditious access to records, documents, and knowledgeable personnel. Section 6 (a) (1), Title 5, U.S. Code, more commonly called the Inspector General Act of 1978, authorizes the IG access to all records, reports, audits, reviews, documents, papers, recommendations, or other material available to the applicable entity.

To provide this access, it is necessary to gather the requested information, or make it available, in a format that is useful to the auditor.

Let’s consider how the PBC lists are used.



Example

PBC Lists (cont.)

Example Entries from a PBC List

Item	Requested Document	Contact and Phone Number	Date Requested	Date Needed	Date Received
	General				
1.	Current version of accounting policies and procedures manual with policies and procedures for Cash and Fund Balance with Treasury, Accounts Receivable, Inventory, Property and Equipment, Advances, Accounts Payable, Accrued Liabilities, and Net Position				
2.	Trial Balance (electronic)				
3.	Access to General Ledger detail				
4.	Crosswalk of accounts to Financial Statement line items				
5.	Statement of intra-departmental elimination entries for FYXXXX				
6.	Management's Discussion and Analysis/Overview				

Version 1.0 **How to Manage Audit Evidential Matter** **L3-6**

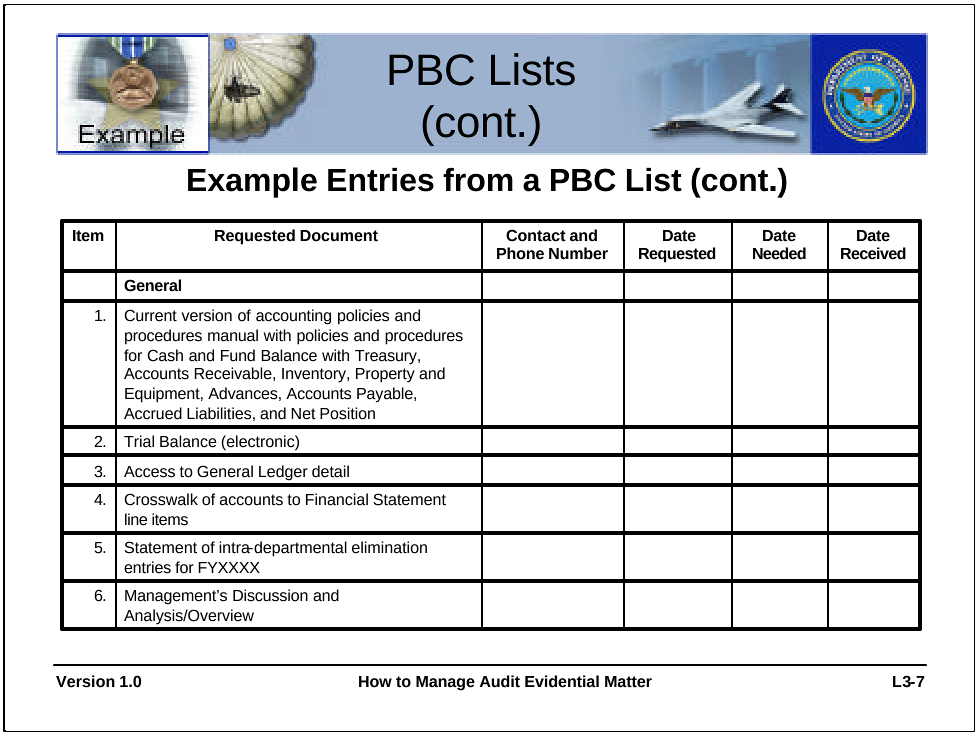
In preparing the PBC list, the auditor determines what information is required from the entity to be audited. In making this determination, the auditor uses selected references such as the GAO/PCIE FAM and other guides, checklists, and professional materials. Using the FAM as an example, the auditor examines the checklist contained in Section II of the manual. The first selection has to do with General Items Related to the Financial Statements and the auditor must determine whether or not the entity's financial statements consist of:

- management's discussion and analysis of the reporting entity
- basic statements and related notes
- required supplementary stewardship information
- required supplementary information
- other accompanying information that provides users of the financial statements with a better understanding of the entity's programs and the extent to which program objectives are achieved.

References to sources of further information are provided within this checklist.

Notice that the first item on the FAM checklist corresponds to requested item number 6 on the PBC list.

Let's look at a few examples of items that may be requested on a PBC list.



PBC Lists (cont.)

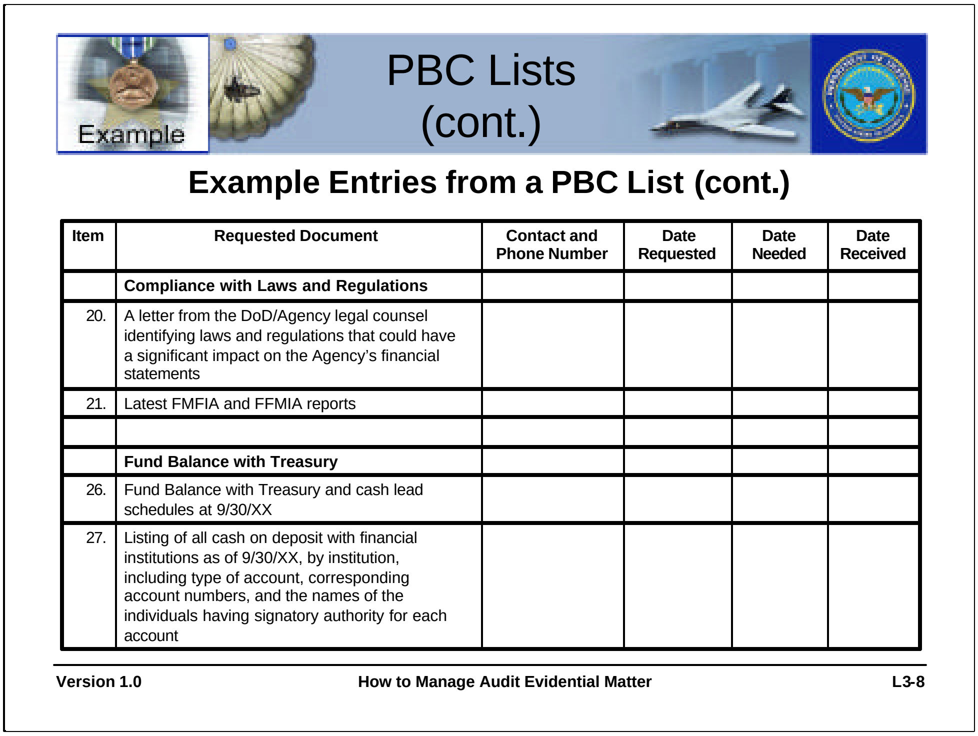
Example Entries from a PBC List (cont.)

Item	Requested Document	Contact and Phone Number	Date Requested	Date Needed	Date Received
	General				
1.	Current version of accounting policies and procedures manual with policies and procedures for Cash and Fund Balance with Treasury, Accounts Receivable, Inventory, Property and Equipment, Advances, Accounts Payable, Accrued Liabilities, and Net Position				
2.	Trial Balance (electronic)				
3.	Access to General Ledger detail				
4.	Crosswalk of accounts to Financial Statement line items				
5.	Statement of intra-departmental elimination entries for FYXXXX				
6.	Management's Discussion and Analysis/Overview				

The first item requests policies and procedures manuals. These manuals should answer the auditors' questions concerning the treatment of financial transactions and their reporting within the financial statements. The auditors must determine what practices are used and whether or not those practices are in accordance with applicable guidance such as GAAP, Generally Accepted Government Auditing Standards (GAGAS), or legal and regulatory guidance.

Other items help the auditors gain an understanding of the entries that make up the financial picture of the entity. Each entity has a slightly different (sometimes extremely different) method of accumulating financial information. The auditors must gain an understanding of that method by learning what individual accounts are consolidated into the amounts reported on the financial statements.

Let's examine a few more entries.



Example

PBC Lists (cont.)

Example Entries from a PBC List (cont.)

Item	Requested Document	Contact and Phone Number	Date Requested	Date Needed	Date Received
	Compliance with Laws and Regulations				
20.	A letter from the DoD/Agency legal counsel identifying laws and regulations that could have a significant impact on the Agency's financial statements				
21.	Latest FMFIA and FFMIA reports				
	Fund Balance with Treasury				
26.	Fund Balance with Treasury and cash lead schedules at 9/30/XX				
27.	Listing of all cash on deposit with financial institutions as of 9/30/XX, by institution, including type of account, corresponding account numbers, and the names of the individuals having signatory authority for each account				

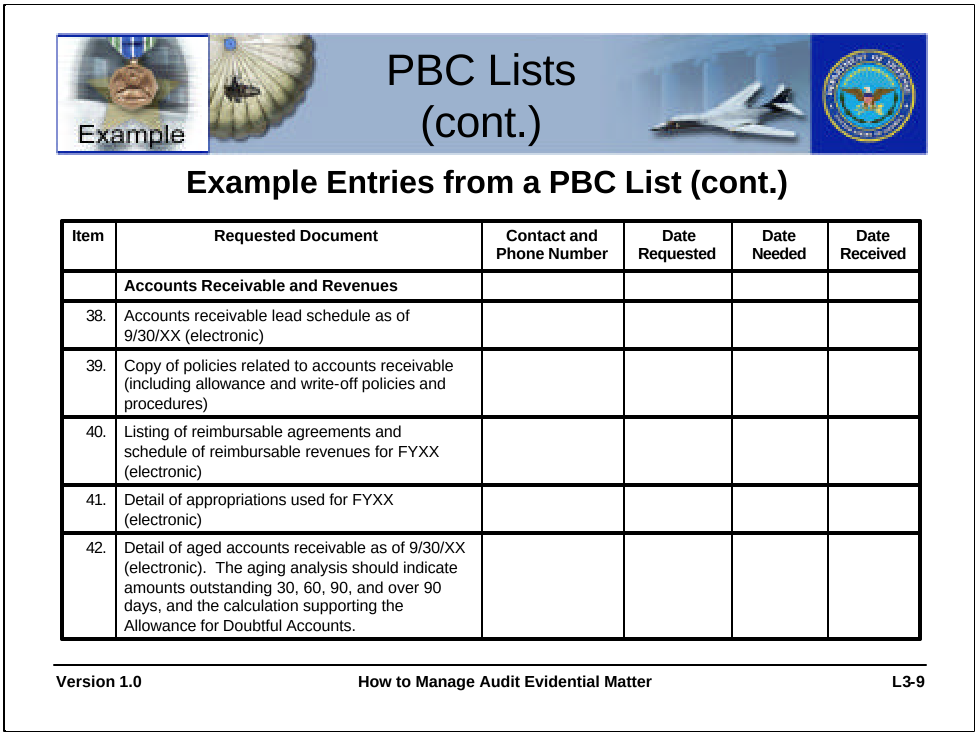
Version 1.0 **How to Manage Audit Evidential Matter** **L3-8**

In the Compliance with Laws and Regulations category, notice that the auditors are requesting a letter from the entity's legal counsel. Compliance with applicable law is essential to a favorable audit opinion. When laws are enacted that affect the way entities operate, the regulatory guidance is changed to reflect the new requirements. In your organization, your SOPs are updated to reflect changes in the regulations that affect your operation.

Remember, on the previous slide, the auditors requested your policies and procedures. Now the auditors will check those procedures against the laws that affect your entity. You can be prepared for this when you gather your procedures by checking them to ensure that they are updated to reflect the latest guidance available. It is important to ensure that once changed, your new procedures are communicated throughout the organization.

In the Fund Balance with Treasury category, the auditors begin to become familiar with your financial information. Persons who are listed as contacts for further information in this area must be able to access the required information, must know how that information is compiled, and must be able to answer questions about any unusual balances or transactions within their designated area of responsibility.

Let's look at a few more.



PBC Lists (cont.)

Example Entries from a PBC List (cont.)

Item	Requested Document	Contact and Phone Number	Date Requested	Date Needed	Date Received
	Accounts Receivable and Revenues				
38.	Accounts receivable lead schedule as of 9/30/XX (electronic)				
39.	Copy of policies related to accounts receivable (including allowance and write-off policies and procedures)				
40.	Listing of reimbursable agreements and schedule of reimbursable revenues for FYXX (electronic)				
41.	Detail of appropriations used for FYXX (electronic)				
42.	Detail of aged accounts receivable as of 9/30/XX (electronic). The aging analysis should indicate amounts outstanding 30, 60, 90, and over 90 days, and the calculation supporting the Allowance for Doubtful Accounts.				

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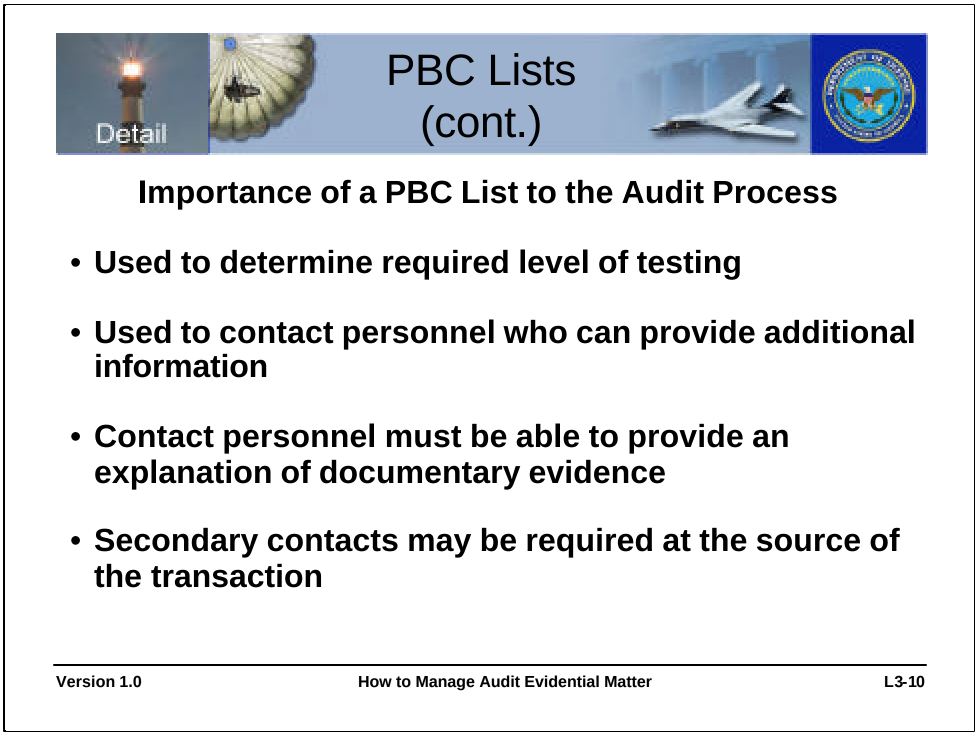
Notice that several of the items requested are electronic files and reports. The auditor specifies the format in which selected items are to be produced. If there is a question concerning an item requested, it must be addressed immediately as the turn-around time from the date requested to the date needed may be very short.

The Accounts Receivable and Revenues category lists reports, schedules, policies, and procedures that allow the auditors to determine the ability of the organization to generate and collect the funds required to maintain its operations. If your collection of amounts owed to your organization is slow, the auditors may determine that your ability to operate may be compromised.

Most items are easily generated or gathered, but some items may require more effort. You should have existing procedures that help make the retrieval process as smooth as possible.

Let's discuss why the PBC list is important.



PBC Lists (cont.)

Importance of a PBC List to the Audit Process

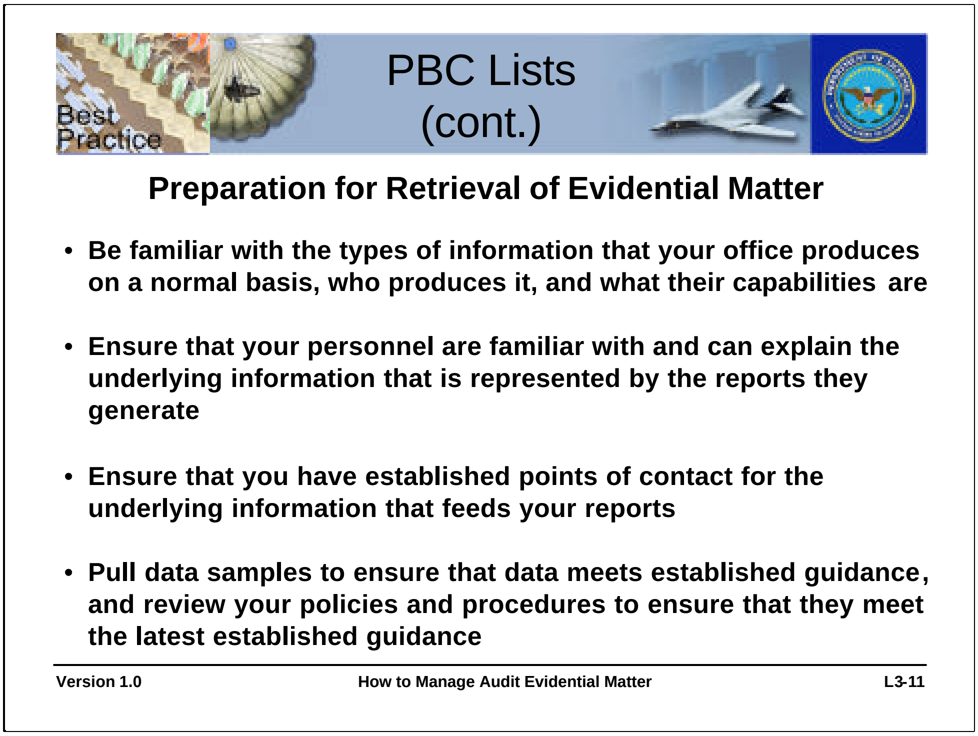
- **Used to determine required level of testing**
- **Used to contact personnel who can provide additional information**
- **Contact personnel must be able to provide an explanation of documentary evidence**
- **Secondary contacts may be required at the source of the transaction**

Once the auditors have reviewed the items requested on the PBC list, the auditors determine the level of testing that may be required to form an opinion on the entity's operations that are represented by those items. That testing is usually done by sampling selected transaction information. This may involve a visit to the office where access to specific transaction files may be viewed.

The auditors' representative contacts the entity to ensure the availability of each required point of contact from the PBC list.

Each point of contact, at the auditors' request, may gather the required transaction samples in accordance with the auditors' instructions. POCs must be able to provide an explanation of the documentary evidence that supports the transaction to be tested, and should have secondary contact procedures for any questions involving source data that must be answered from the source of the transaction.

Now let's consider how to prepare your entity for the requirements just outlined.



Best Practice

PBC Lists (cont.)

Preparation for Retrieval of Evidential Matter

- **Be familiar with the types of information that your office produces on a normal basis, who produces it, and what their capabilities are**
- **Ensure that your personnel are familiar with and can explain the underlying information that is represented by the reports they generate**
- **Ensure that you have established points of contact for the underlying information that feeds your reports**
- **Pull data samples to ensure that data meets established guidance, and review your policies and procedures to ensure that they meet the latest established guidance**

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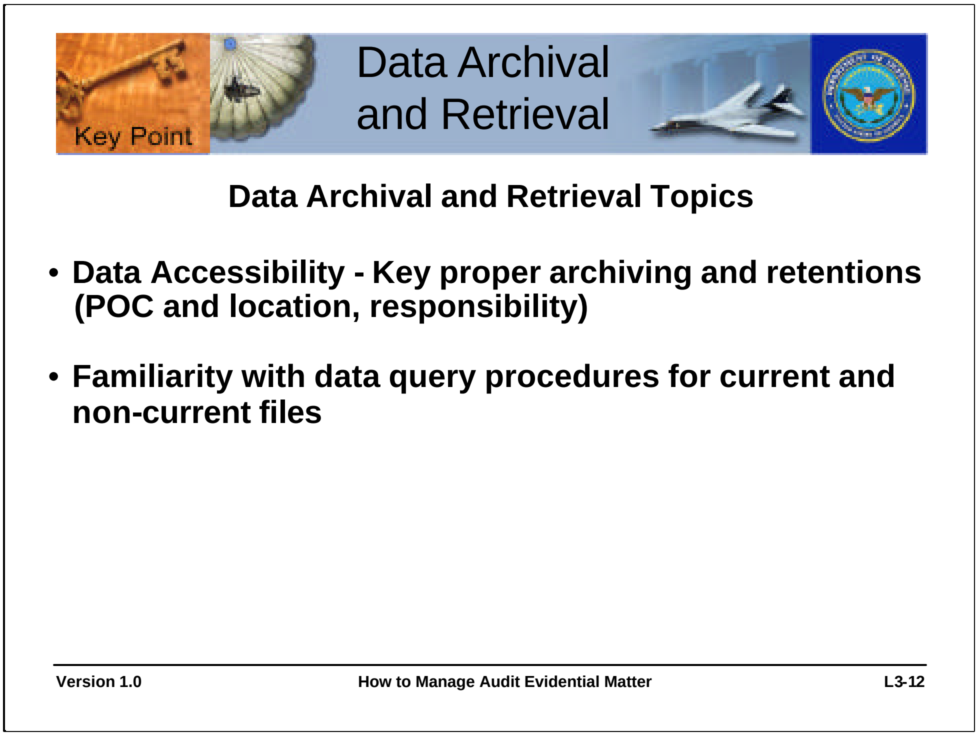
First, you must be familiar with the types of information that your office produces on a normal basis. You must know who produces what, and what their capabilities are for providing that information in reportable formats. If your personnel require training, now is the time to provide it.

Ensure that your personnel are familiar with and can explain the underlying information that is represented by the reports they generate. Can they articulately explain this information? Do they have the authority to speak for the organization in the area that they represent? If they do not, is the person with the authority readily available?

Ensure that you have established POCs for the underlying information that feeds your reports. Do your personnel know who provides the underlying information that feeds their reports?

Pull data samples to ensure that data meets established guidance, and review your policies and procedures to ensure that they meet the latest established guidance. Are all affected personnel familiar with the new guidance?

Now that we've covered the PBC list, let's look at data archival and retrieval.



Data Archival and Retrieval

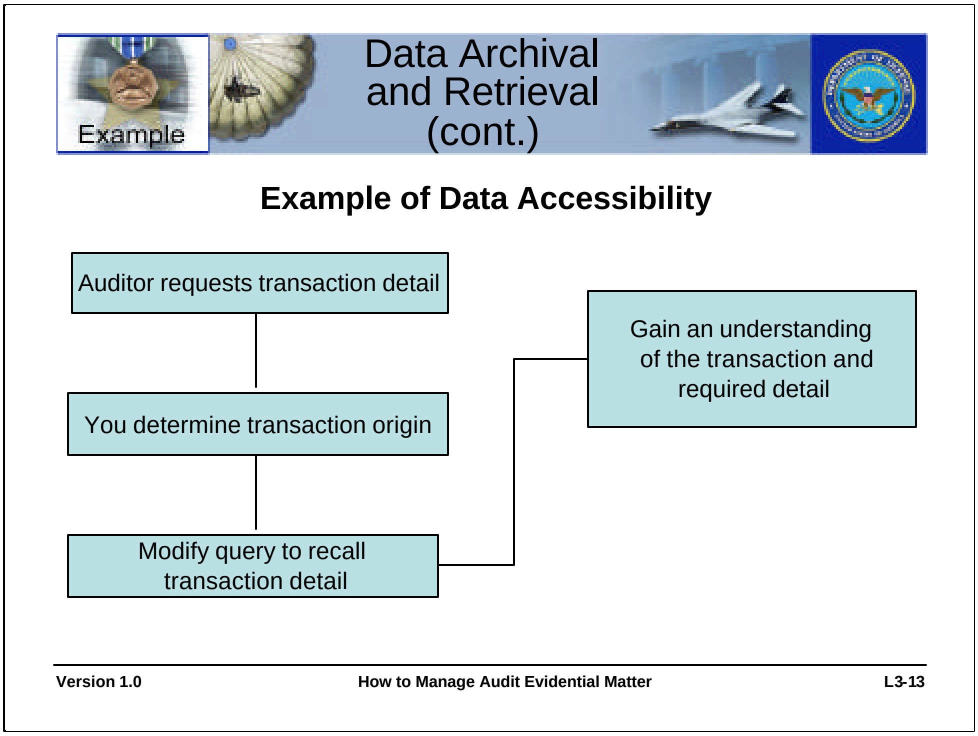
Data Archival and Retrieval Topics

- **Data Accessibility - Key proper archiving and retentions (POC and location, responsibility)**
- **Familiarity with data query procedures for current and non-current files**

Data accessibility is critical to the success of the audit. The key to data accessibility is the proper archiving and retention of essential records. If the required records exist and are properly archived, then access procedures may be written and followed that result in the capture of these records in a timely manner.

Most records are currently maintained within computerized systems. Use of properly formatted data queries should provide the required data. The exception to this premise is when the required data has been removed from the current system files or when changes to systems no longer allow access to historical information. You must have procedures in place to access both current files and non-current files.

Let’s illustrate data accessibility with an example.



Example

Data Archival and Retrieval (cont.)

Example of Data Accessibility

Auditor requests transaction detail

You determine transaction origin

Modify query to recall transaction detail

Gain an understanding of the transaction and required detail

Version 1.0 How to Manage Audit Evidential Matter L3-13

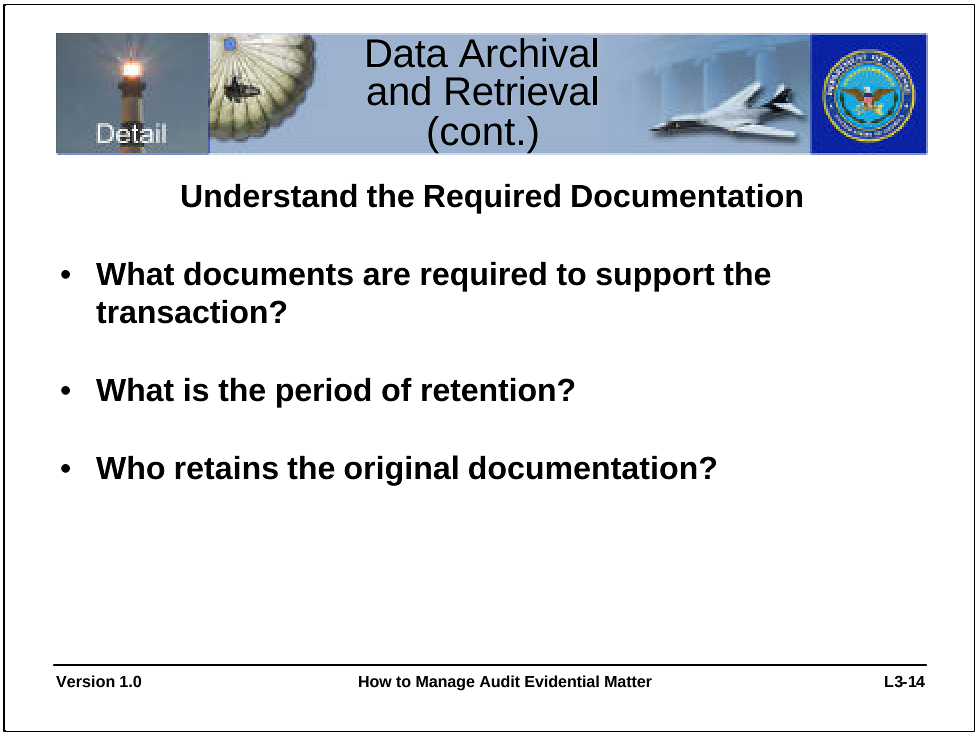
You are the POC on the PBC list for payment transactions affecting your entity. An auditor has requested verification of a contract payment in accordance with a lease agreement as part of a random selection of transactions to be tested for completeness.

Using the cycle memorandum, you determine that the USSGL account reported within the affected line item on the financial statements was processed through an accounting systems such as STANFINS, SOMARDS, GAFS, STARS, or SABRS. You then traced the transaction to a Vendor Pay transaction that entered into the accounting system through a system such as CAPS, Mechanization of Contract Administration Services (MOCAS), IAPS, or Deployable Disbursing System (DDS).

Once you understand the origin of the affected transaction, you can design a system query to recall the transaction detail, or you may already have pre-existing queries that can be modified to fit the required data.

Knowing the rules that affect Vendor Pay transactions may assist in knowing the detail required for this transaction.

Let’s examine some of the rules that affect this transaction.



Detail

Data Archival and Retrieval (cont.)

Understand the Required Documentation

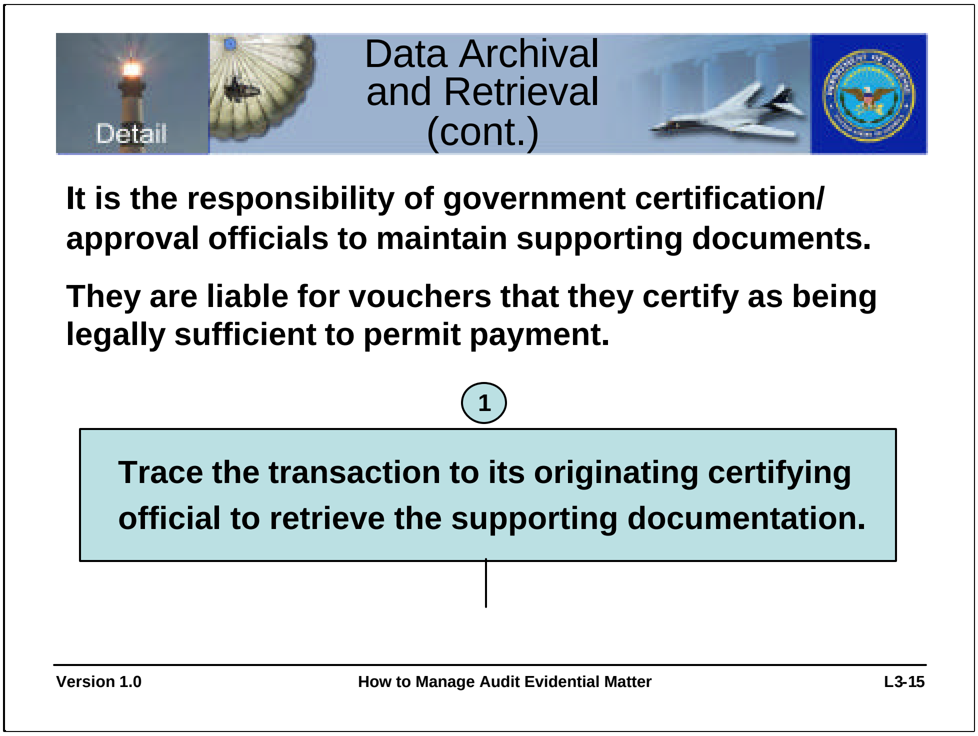
- **What documents are required to support the transaction?**
- **What is the period of retention?**
- **Who retains the original documentation?**

Version 1.0 How to Manage Audit Evidential Matter L3-14

According to the DoDFMR, disbursing office records and associated papers must be readily accessible to the Disbursing Office or the designated settlement office for a period of six years and three months. It also states that this period may be extended to complete reconciliation of payment or collection discrepancies, or for other necessary purposes. This requirement applies to both paper and electronic records regardless of whether the original supporting documents are maintained at the source (preparing) office or at the Disbursing Office.

Several examples of Disbursing Office records may include fund authorization documents, purchase request and commitment documents, obligation documents, and disbursement and collection vouchers. Supporting documents may include invoices, receiving reports, purchase orders or contracts, and lodging receipts; voucher control logs; Daily Statements of Accountability (DD Form 2657); check issue records and reports; records of deposits; accountable individual appointments and revocations; and any other required documents.

Let’s assume that this transaction was processed through CAPS on an externally certified SF 1034, Public Voucher for Purchases and Services Other Than Personal.



Detail

Data Archival and Retrieval (cont.)

It is the responsibility of government certification/ approval officials to maintain supporting documents.

They are liable for vouchers that they certify as being legally sufficient to permit payment.

①

Trace the transaction to its originating certifying official to retrieve the supporting documentation.

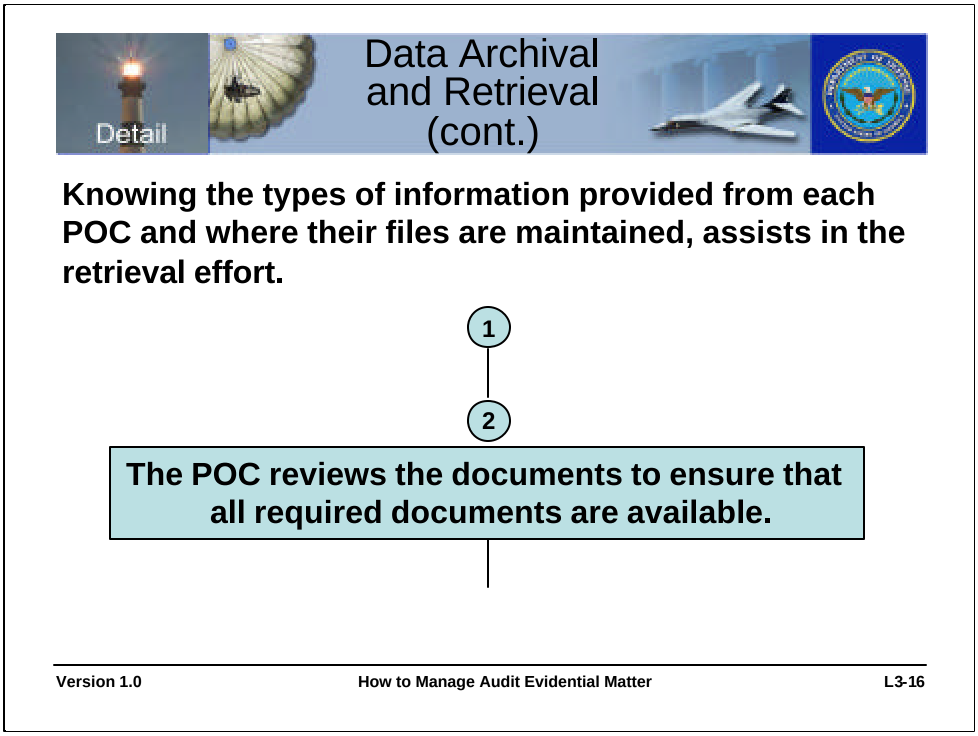
Version 1.0 How to Manage Audit Evidential Matter L3-15

According to the DFAS Vendor Pay Product Line, CAPS Operations SOP, lease and rental agreements, that are paid on an externally certified SF 1034 and supported by an invoice and lease or rental agreement, are classified as miscellaneous payments and are processed through CAPS.

You find that externally certified payment vouchers do not require supporting documents to accompany the request for payment, but that it is the responsibility of government certification/approval officials to maintain supporting documents, and they are liable for vouchers they certify as being legally sufficient to permit payment.

You must now trace the transaction to its originating certifying official to retrieve the supporting documentation.

Let’s consider how the POC adds to your ability to retrieve this data.



Detail

Data Archival and Retrieval (cont.)

Knowing the types of information provided from each POC and where their files are maintained, assists in the retrieval effort.

1

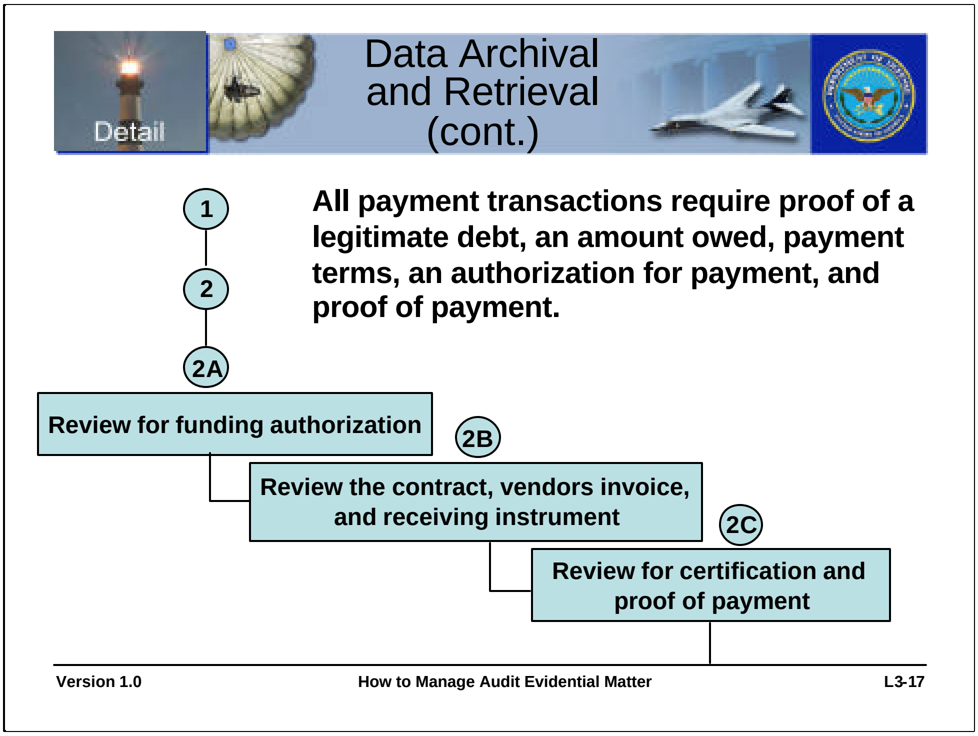
2

The POC reviews the documents to ensure that all required documents are available.

The contact for evidential matter listed on the PBC list should maintain a listing of POCs and locations where supporting information that feeds the items reported under his or her area of responsibility are maintained. Knowing the types of information provided from each POC and where their files are maintained assists in the retrieval effort.

The POC may be the individual who initially input a transaction, or who regularly queries similar transactions and is familiar with the document filing procedures. By knowing which system received the input file and the file naming convention, the POC can electronically reproduce the transaction documents.

Let’s discuss the documentation that must be captured to prove the completeness of this transaction.



Detail

Data Archival and Retrieval (cont.)

1
2
2A
2B
2C

All payment transactions require proof of a legitimate debt, an amount owed, payment terms, an authorization for payment, and proof of payment.

Review for funding authorization

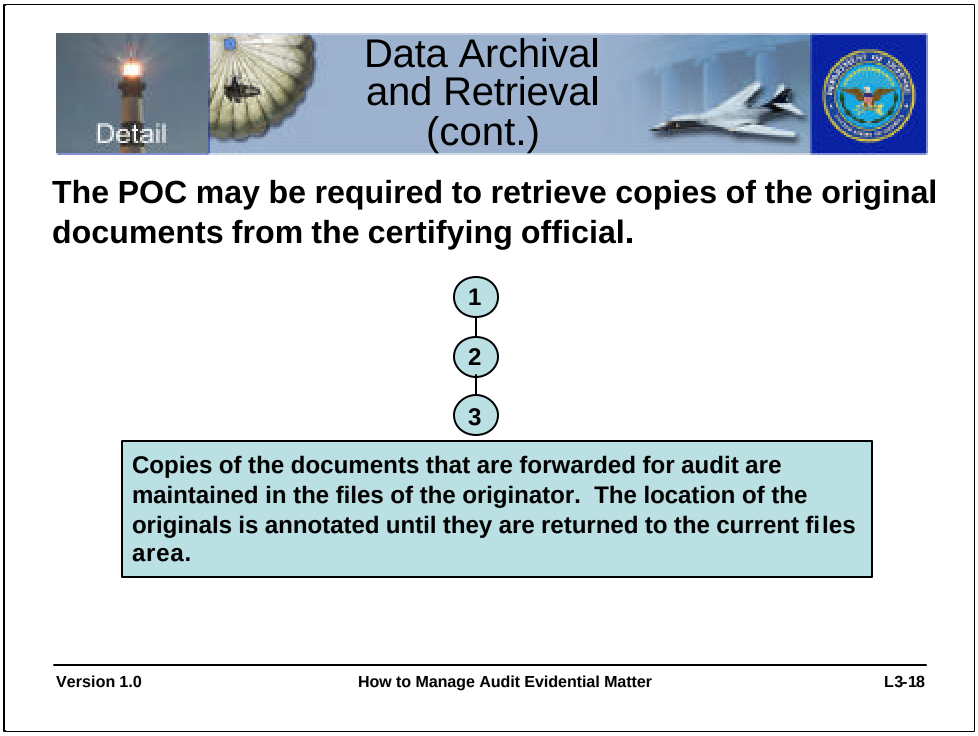
Review the contract, vendors invoice, and receiving instrument

Review for certification and proof of payment

This transaction involves the payment of a lease for property. All payment transactions require proof of a legitimate debt, an amount owed, payment terms, an authorization for payment, and proof of payment. Also required is proof that funds were authorized and available for the specified use. To ensure that you have all of the required documentation, you review for funding authorization. At the time of the obligation, did the entity incurring the debt have funds available in the correct appropriation, and were those funds allocated for the purpose specified?

To ensure that a legitimate debt was incurred, review the contract, vendor's invoice, and receiving instrument. The receiving instrument should confirm that the leased property was available for use to the entity in accordance with the terms of the contract and should be signed and dated by an authorized individual. The invoice should be dated, specify the amount owed and the date payment is due or other payment terms, and describe the item or service rendered for which the payment is to be made. The contract specifies the terms under which the goods or services are to be provided, any payment terms, and the time of performance under the contract. You also review the contract for authorizing signatures and dates.

The certifying official should have annotated by signature that documentation is legally sufficient to permit payment. Proof of payment may be in the form of the recording of an electronic funds transfer or a cancelled check written to the vendor and may be retrieved through system inquiry. Payments are reviewed for their timeliness and whether any interest owed was paid in accordance with Chapter 39, Prompt Payment, Title 31, U.S. Code.



Data Archival and Retrieval (cont.)

The POC may be required to retrieve copies of the original documents from the certifying official.

1

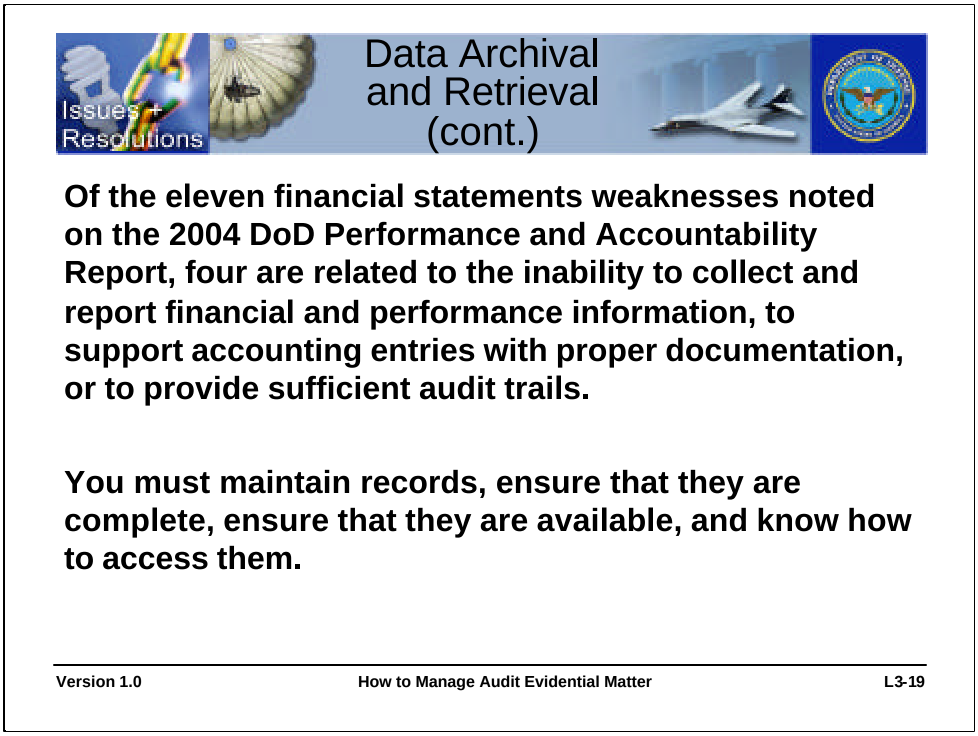
2

3

Copies of the documents that are forwarded for audit are maintained in the files of the originator. The location of the originals is annotated until they are returned to the current files area.

Version 1.0 How to Manage Audit Evidential Matter L3-18

Earlier we noted that this was an externally certified payment. Since the payment was externally certified, several documents may not be scanned into the electronic files for easy access. If this is the case, you may be required to retrieve copies of the original documents from the certifying official. If original documents are required for the audit, copies of the documents that are forwarded for audit are maintained in the files of the originator with an annotation as to the location of the originals until the originals are returned to the current files area.


Issues + Resolutions

Data Archival and Retrieval (cont.)

Of the eleven financial statements weaknesses noted on the 2004 DoD Performance and Accountability Report, four are related to the inability to collect and report financial and performance information, to support accounting entries with proper documentation, or to provide sufficient audit trails.

You must maintain records, ensure that they are complete, ensure that they are available, and know how to access them.

Version 1.0 How to Manage Audit Evidential Matter L3-19

Of the eleven financial statements weaknesses noted on the 2004 DoD Performance and Accountability Report, four are due in large part to the inability of financial management systems and business processes to:

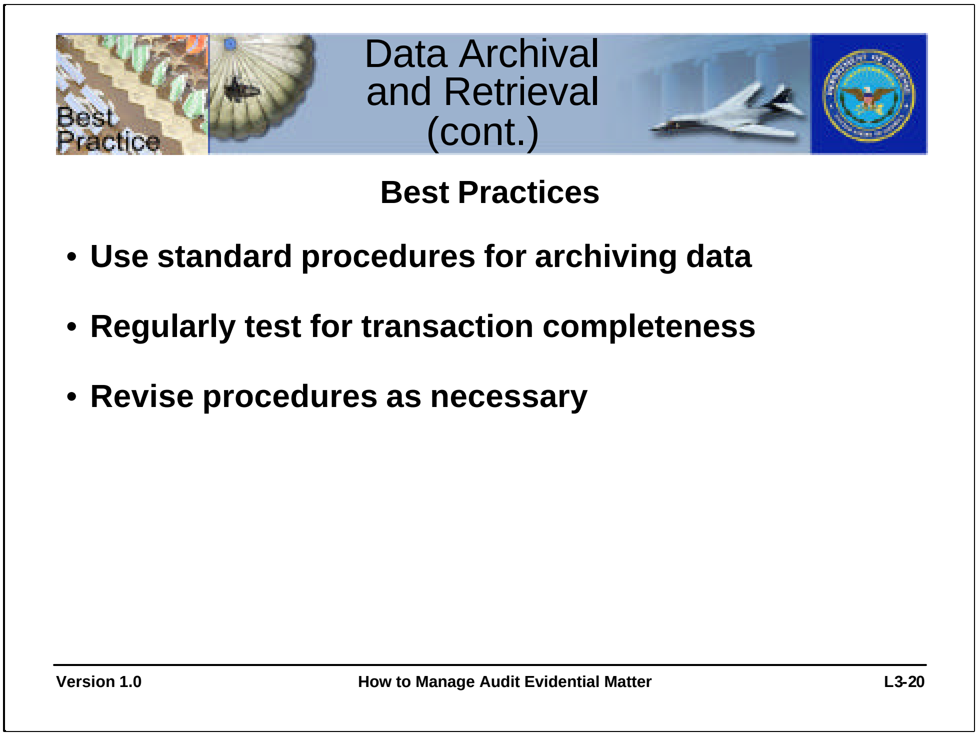
- collect and report financial and performance information
- support accounting entries with proper documentation
- provide sufficient audit trails.

Think about the number of documents required to prove the completeness of the payment transaction we just went through. Now think about all the activities/transactions that are performed on a daily basis throughout the various DoD entities. For example, in a hospital, when medicines are dispensed, are inventory control records updated? Are records of periodic inventories maintained? Are patient records annotated when patient medications are dispensed? Are codes entered for reimbursement of costs and restock of material used?

In a machine shop, grease, oil, and spare parts are ordered through a supply system. Upon receipt, are receiving documents signed? Are parts inventories conducted? Is work performed annotated on maintenance records? Are parts and labor charged to the customer?

At the property book office, is there documentation to support the legitimate transfer of ownership to or from the government of property held by the installation? Are inventories of property, plant, and equipment conducted regularly? Are detailed records available to support cost estimates? Is historical cost information available? If not, are there procedures in place to estimate these costs?

Once you've identified the records required to substantiate financial transactions, you must have procedures in place to readily retrieve those records.


Best Practice

Data Archival and Retrieval (cont.)

Best Practices

- **Use standard procedures for archiving data**
- **Regularly test for transaction completeness**
- **Revise procedures as necessary**

The use of physical folders to organize audit material is one recommended practice. Folders may contain actual hard-copy documents that were requested, or may contain instructions on how to access common records that are required. Electronic copies of reports generated at specific intervals throughout the audit period may be required due to the constant flux of data. Systems upgrades are constantly occurring, and you must have a record of the information that supported the decision-making and reporting processes.

Common procedures for archiving data must be adhered to in order to be able to retrieve the data using standard inquiries. For example, the format of the document number may be used to recall documents containing common elements. Elements in the accounting line may be used as discriminators for the compilation of similar documents. Transaction dates, contract numbers, Electronic Funds Transfer (EFT) numbers, check numbers, vendor or customer numbers, or other discriminators may also be used.

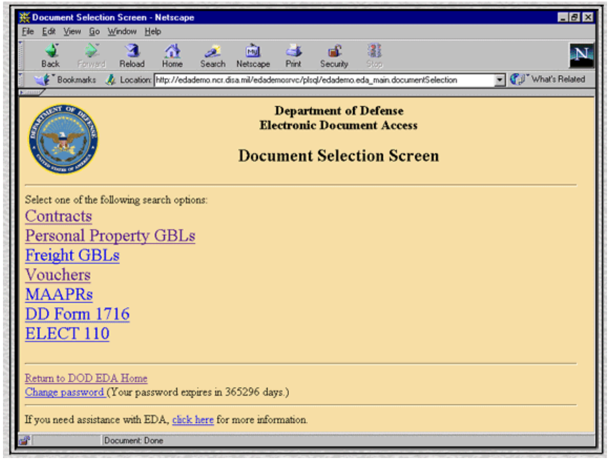
Regularly test for transaction completeness and revise procedures as necessary to ensure the availability of documentation. Remember that documentation to support a financial transaction may not appear to be financially related. Such documentation may include inventories, time cards, service contracts, usage records, and deeds, just to name a few.

Now let’s look at file retrieval tools.

Key Point

File Retrieval Tools

Electronic Document Access (EDA)


Document Selection Screen - Netscape
File Edit View Go Window Help
Back
Forward
Reload
Home
Search
Netscape
Print
Security
Stop
Bookmarks
Location:
What's Related

http://edademo.ncr.disa.mil/edademosrvc/plsql/edademo.eda_main.documentSelection

Department of Defense
Electronic Document Access

Document Selection Screen

Select one of the following search options:
Contracts
Personal Property GBLs
Freight GBLs
Vouchers
MAAPRs
DD Form 1716
ELECT 110

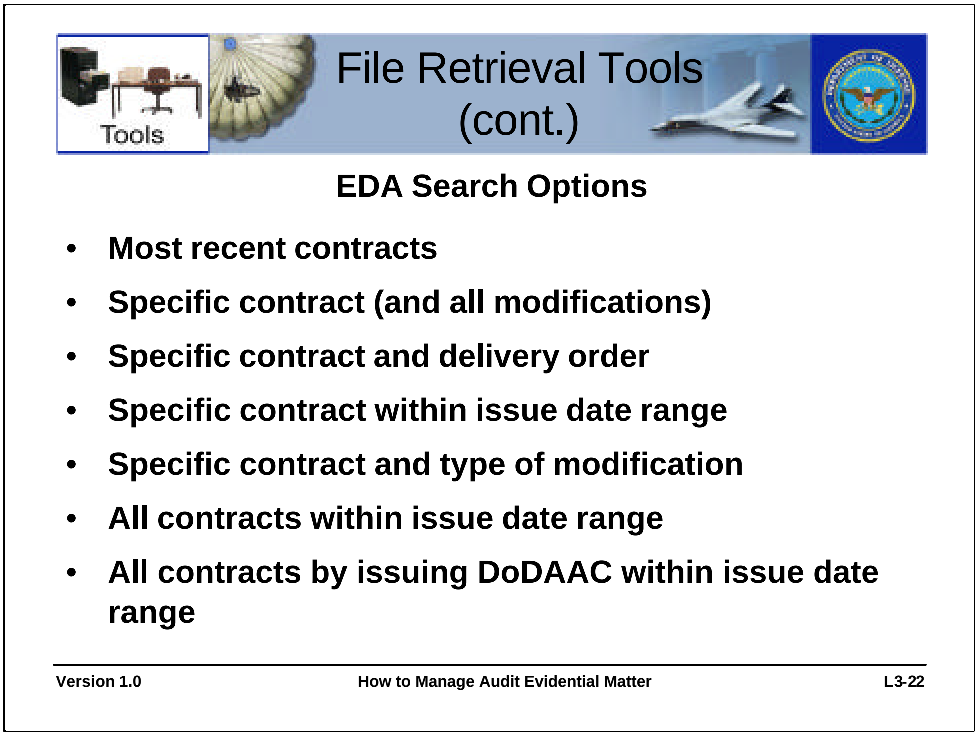
Return to DOD EDA Home
Change password (Your password expires in 365296 days.)

If you need assistance with EDA, click here for more information.

Document: Done

EDA authorization enables your agency to store and retrieve documents electronically, which reduces the need for printing, mailing, and filing paper documents. Documents available through EDA include post-award contracts, contract modifications, personal property and freight bills of lading, payment vouchers, contract deficiency reports, summaries of voucher line data, material acceptance and accounts payable reports, and government transportation requests. EDA authorization offers a paperless certification, which is based upon accuracy and timeliness, providing DFAS payment technicians, DoD contract officers, procurement officers, program and financial managers, and transportation officers with the ability to view and process documents without paper copies.

Let’s see how EDA works.



File Retrieval Tools (cont.)

EDA Search Options

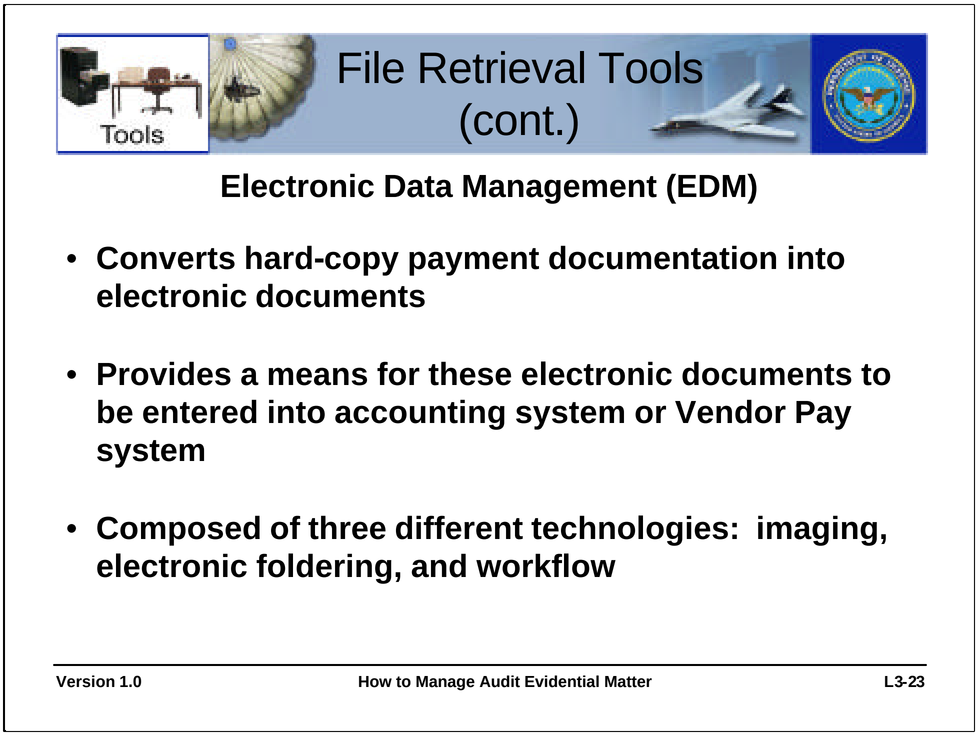
- **Most recent contracts**
- **Specific contract (and all modifications)**
- **Specific contract and delivery order**
- **Specific contract within issue date range**
- **Specific contract and type of modification**
- **All contracts within issue date range**
- **All contracts by issuing DoDAAC within issue date range**

Search options within EDA include: search for most recent contracts, search for a specific contract (and all modifications), search for a specific contract and delivery order, search for a specific contract within issue date range, search for a specific contract and modification type (Administrative (A) or Procurement (P)), search for all contracts within issue date range, or search for all contracts by issuing Department of Defense Activity Address Code (DoDAAC) within issue date range. Similar search options are available for property or freight bills of lading and vouchers.

The document you select is retrieved and opened into the Acrobat Reader Window on your Personal Computer (PC). From this window, you can navigate through the document, or copy portions of the document and paste them into other documents you may be working on. What you cannot do is to modify the original document in any way.

What this means to the audit effort is that documents scanned into EDA may be accessed by the POC for viewing by the auditor without waiting for the arrival of hard-copy documents. Documents scanned into the system are coded by contract number and a record is created of the date/time of entry into the system. Since this is a read-only system, it is less vulnerable to manipulation and provides more credible audit evidence than computer-generated documents that can be edited.

Another technology tool used is the EDM system. Let's examine this system.



File Retrieval Tools (cont.)

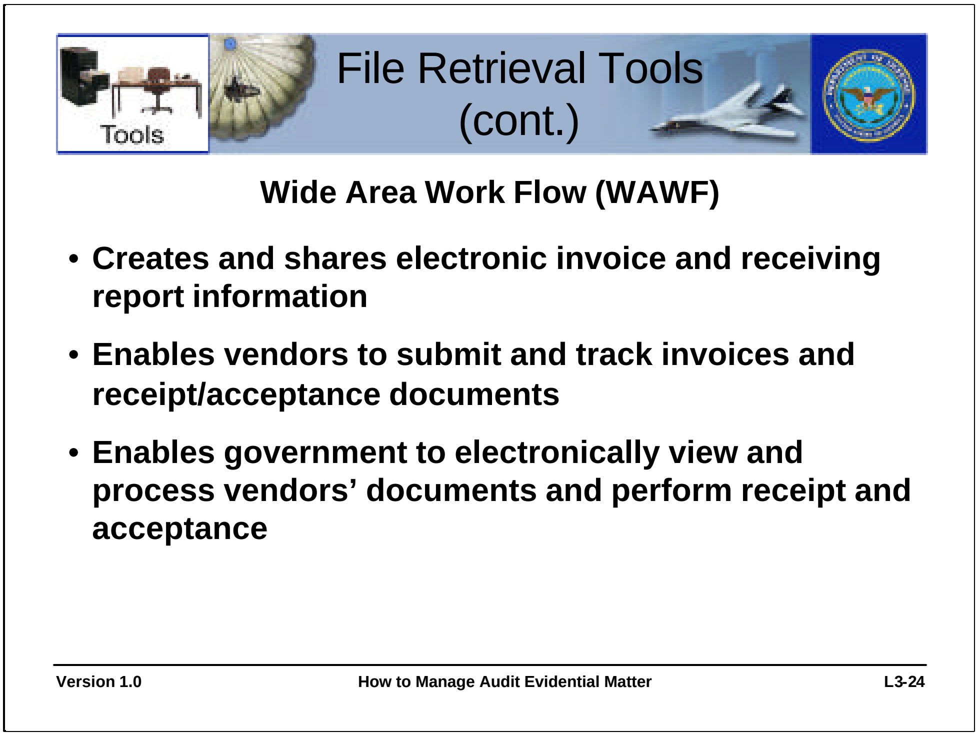
Electronic Data Management (EDM)

- **Converts hard-copy payment documentation into electronic documents**
- **Provides a means for these electronic documents to be entered into accounting system or Vendor Pay system**
- **Composed of three different technologies: imaging, electronic foldering, and workflow**

EDM was created to convert hard-copy payment documentation into electronic documents. It provides a means for these electronic documents to be routed through the Finance Directorate and entered into IAPS. EDM is composed of three different technologies: imaging, electronic foldering, and workflow. Together they form a system that manages information without paper.

The preferred method of receipt of documents to be input into EDM is by fax. Once faxed documents are received, the EDM Autofax process picks them up and processes them into EDM. When input manually, they are cataloged and prepared prior to scan.

Let’s examine the next tool.



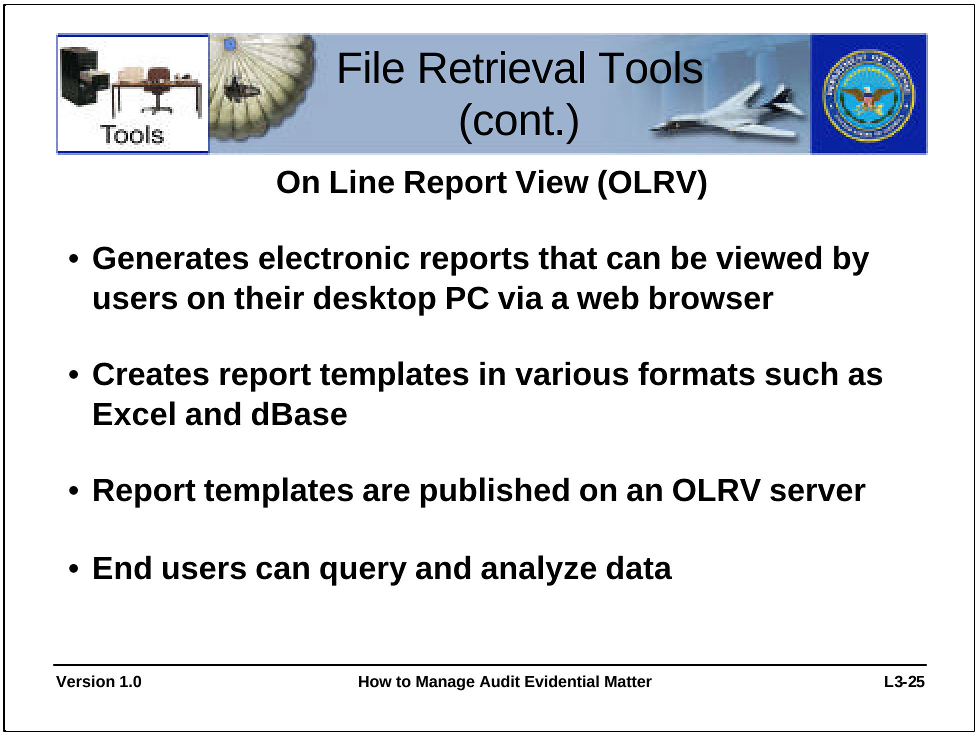
File Retrieval Tools (cont.)

Wide Area Work Flow (WAWF)

- **Creates and shares electronic invoice and receiving report information**
- **Enables vendors to submit and track invoices and receipt/acceptance documents**
- **Enables government to electronically view and process vendors' documents and perform receipt and acceptance**

WAWF is a software application that was developed to electronically create and share invoice and receiving report information. It enables vendors to submit and track their invoice and receipt/acceptance documents. It also enables the government to electronically view and process this data and perform government receipt and acceptance from vendors and receipt certification from government personnel by use of Internet technology.

Let's examine OLRV.



File Retrieval Tools (cont.)

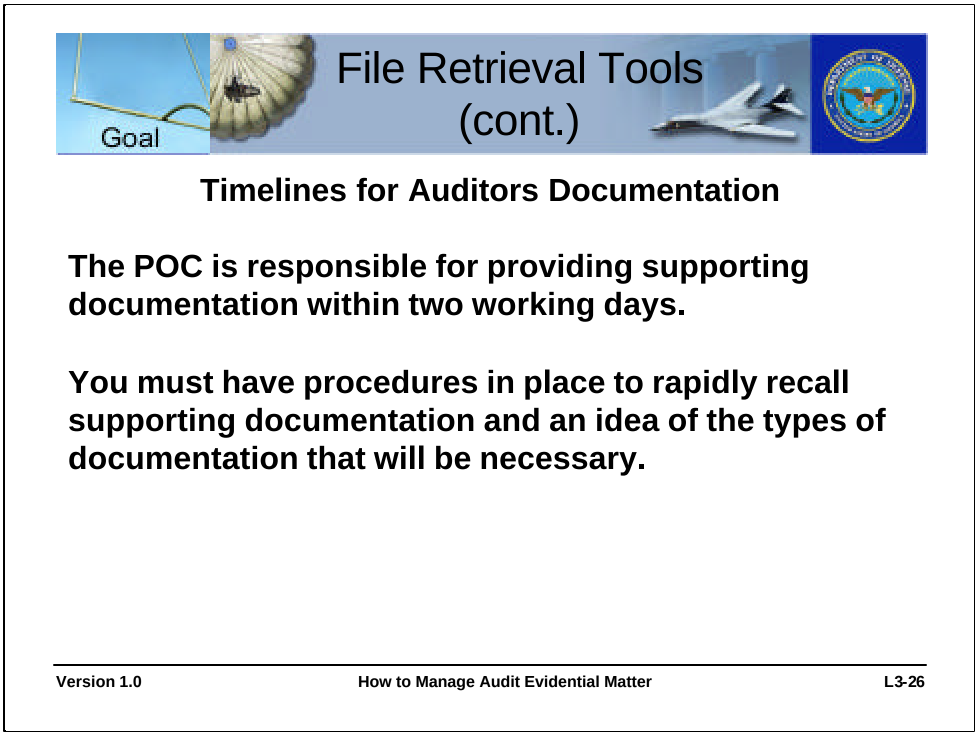
On Line Report View (OLRV)

- **Generates electronic reports that can be viewed by users on their desktop PC via a web browser**
- **Creates report templates in various formats such as Excel and dBase**
- **Report templates are published on an OLRV server**
- **End users can query and analyze data**

OLRV is the DFAS standard paperless report initiative. OLRV takes data (reports) normally printed from a system such as STANFINS and generates an electronic report that can be viewed by users on their desktop PC via a web browser. End users can also query and analyze data. Behind the scenes, a DFAS site modeler creates a report template. Based on customer needs, templates can be created in various formats such as Excel and dBase, which are then published on an OLRV server by the server administrator.

The Accounting Service Business Line is the primary user of OLRV, followed by Military and Civilian Pay and Commercial Pay Services. Each business line has assigned an OLRV workgroup representative to help manage OLRV.

Let’s discuss the timelines for providing documentation to auditors.



File Retrieval Tools (cont.)

Timelines for Auditors Documentation

The POC is responsible for providing supporting documentation within two working days.

You must have procedures in place to rapidly recall supporting documentation and an idea of the types of documentation that will be necessary.

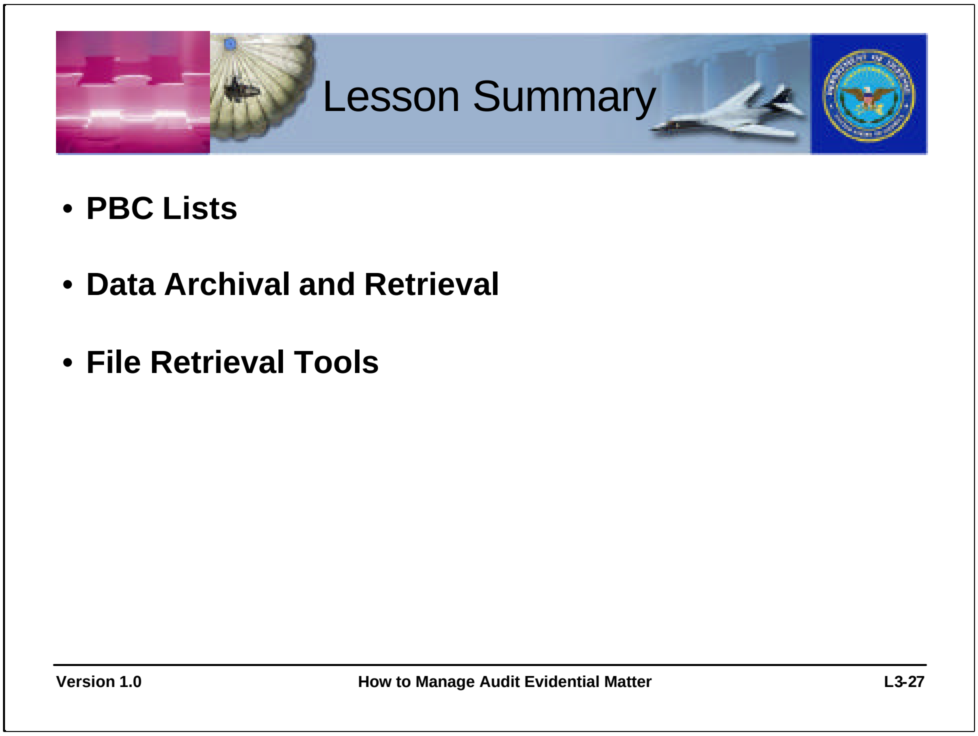
Version 1.0 How to Manage Audit Evidential Matter L3-26

According to the IG memorandum, Subject: Auditor Access for Financial Statement Audits, dated January 24, 2005, new procedures for auditor access to information and personnel must be established. It states that the high priority assigned to financial statement audits, the need to rapidly access documentation, and stringent timelines for completion necessitate this change.

Once the auditors have reviewed documents supplied in the assertion package and those items listed on the PBC list, they request supporting documentation. The POC is now responsible for providing this documentation within two working days. If an entity needs more than two days to provide the requested data, then the DoD OIG and reporting entity POCs will coordinate an acceptable turnaround time for providing the documents to the auditors.

You can see now why you must have procedures in place to rapidly recall supporting documentation and an idea of the types of documentation that will be necessary. You must be familiar with file retrieval tools and locations of files, both hard copy and electronic, as well as code structures or elements to be used in queries as discriminators for the recall of these detailed documents.

Let’s summarize what we learned in this lesson.



Lesson Summary

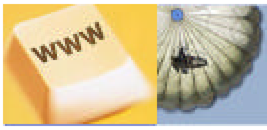
- **PBC Lists**
- **Data Archival and Retrieval**
- **File Retrieval Tools**

The PBC list is a checklist of requested documents or other deliverable items broken down into several categories and numbered for ease of reference. These items are required by the auditors to enable them to adequately audit your organization. The PBC list provides a timeline and control sheet on the receipt of the requested information, and once completed, it serves as a resource for the audit team to determine who they can obtain further information from concerning the requested items.

When you understand the origin of an affected transaction, you can design a system query to recall the transaction detail, or you may already have queries that can be modified to fit the required data. You may have to trace the transaction to its originating certifying official to retrieve the supporting documentation. You then must review the retrieved transaction documents to ensure that they are complete. In a transaction that requires payment, you review for funding authorization; review the contract, vendors invoice, and receiving instrument; and review for certification and proof of payment. Retain copies of the original documents that are forwarded for audit, and annotate the location of the original documents in the files until the originals are returned.

Electronic media has greatly enhanced the ability of the Department to access, manage, and view required documents and reports.

The following slide lists references available for additional information.

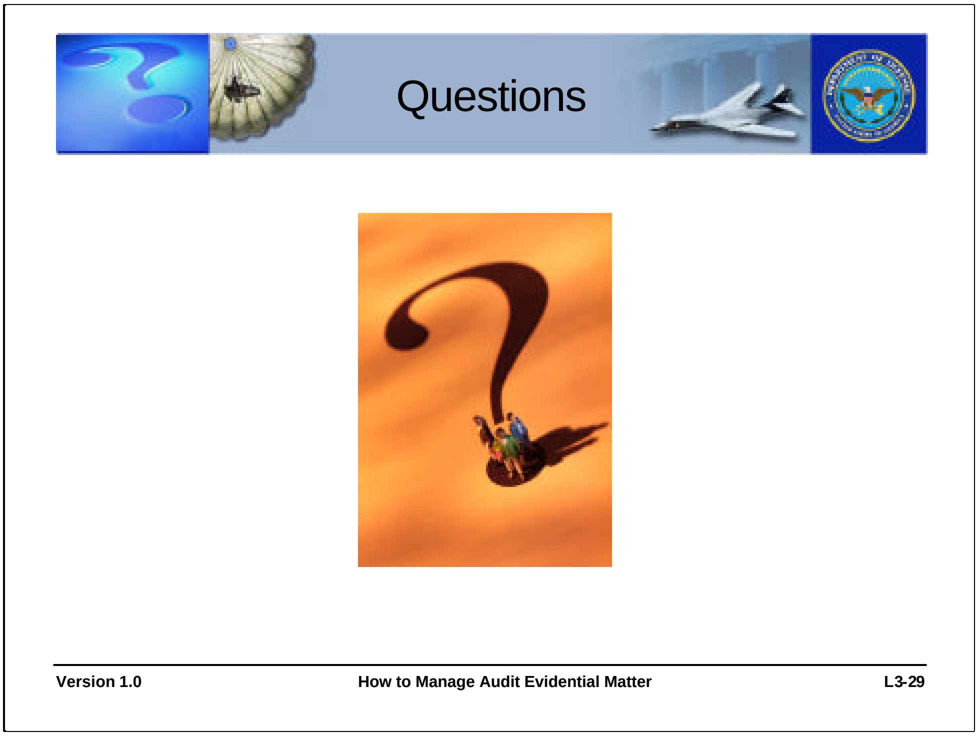


References

U.S. Code, Title 5 (Inspector General Act) and Title 31 (Prompt Payment): http://www.uscode.house.gov

GAO/PCIE FAM: http://www.gao.gov

Selected articles and operating procedures on https://eportal.dfas.mil



Questions

Do you have any questions on the material covered in this lesson?

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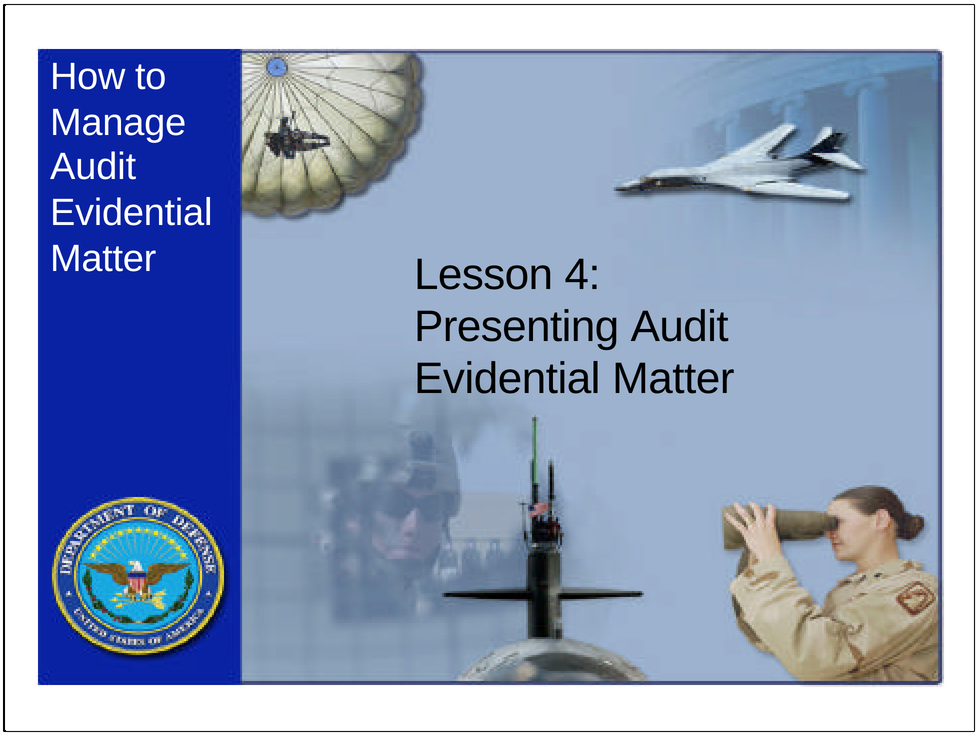
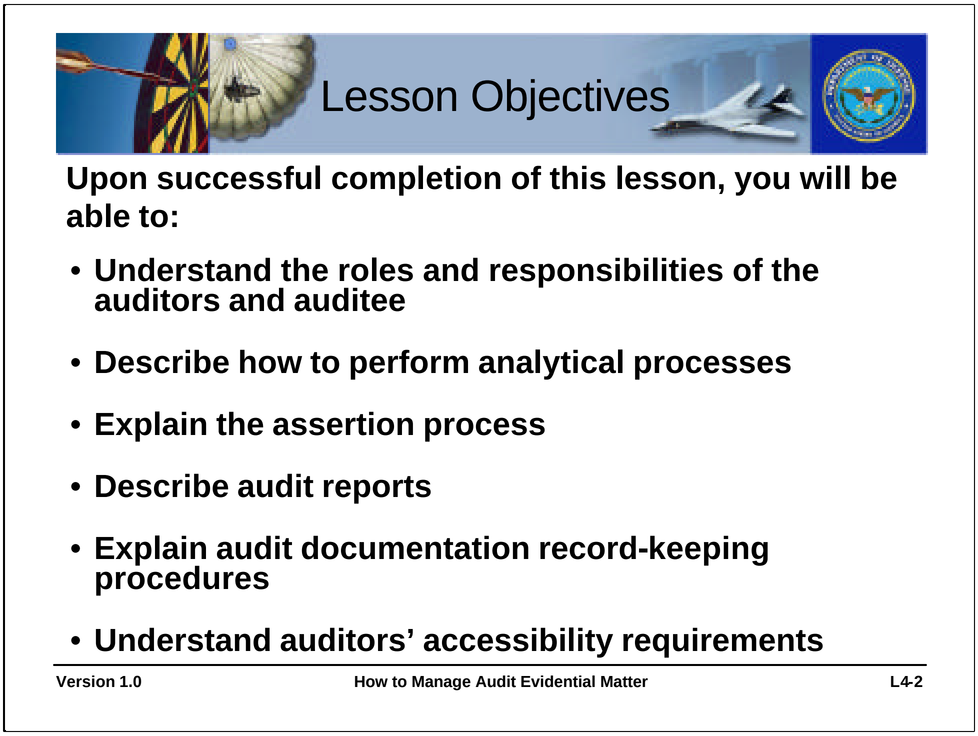


How to Manage Audit Evidential Matter

Lesson 4:
Presenting Audit Evidential Matter

In Lesson 4, we explore how audit evidential matter is presented.

The art of presenting audit evidential matter requires confidence and assurance in both the spoken and written material presented. Evidential matter and its presentation must be both convincing and persuasive. Understanding this process will allow you to present a demeanor that portrays confidence to the auditors and provides the foundation for an unqualified audit opinion.



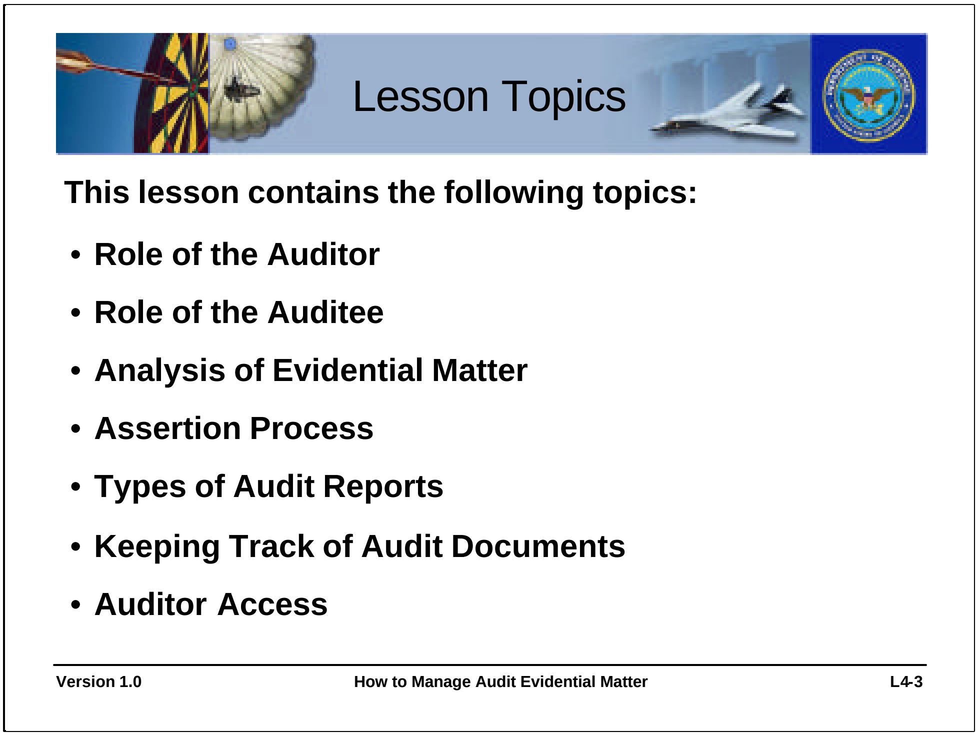
Lesson Objectives

Upon successful completion of this lesson, you will be able to:

- **Understand the roles and responsibilities of the auditors and auditee**
- **Describe how to perform analytical processes**
- **Explain the assertion process**
- **Describe audit reports**
- **Explain audit documentation record-keeping procedures**
- **Understand auditors’ accessibility requirements**

In this lesson, we discuss the roles and responsibilities of the auditors and the auditees. We describe how to perform analytical processes. We then will examine the assertion process, and describe audit reports in detail. We then explain audit documentation record-keeping procedures. We conclude with a description of the auditors’ access to personnel and documentation.

Let’s discuss the lesson topics.



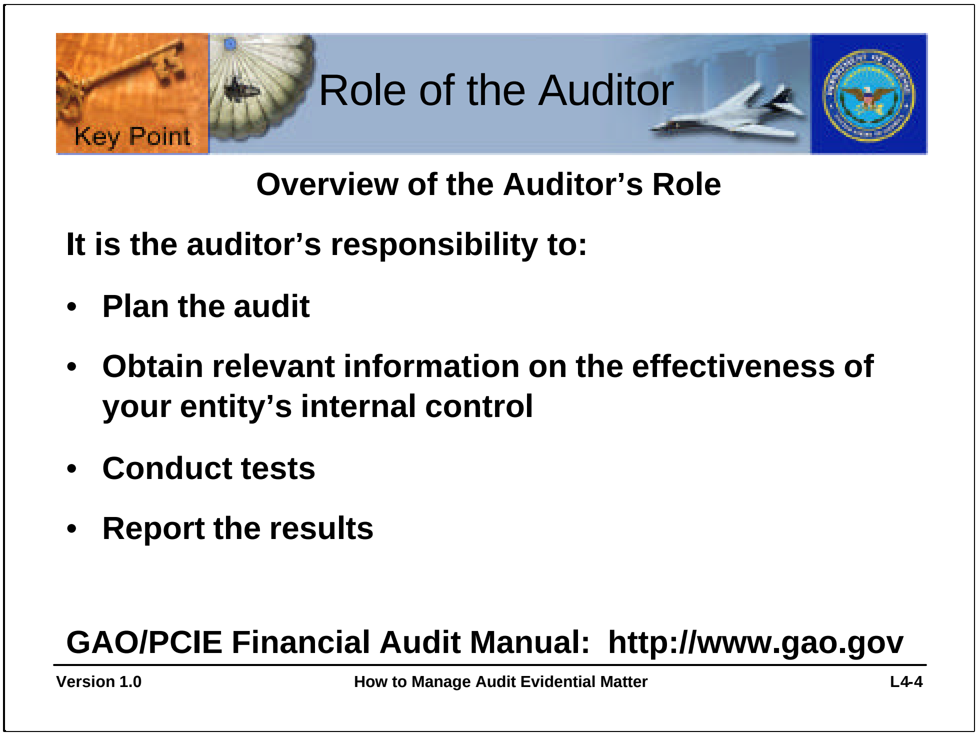
Lesson Topics

This lesson contains the following topics:

- **Role of the Auditor**
- **Role of the Auditee**
- **Analysis of Evidential Matter**
- **Assertion Process**
- **Types of Audit Reports**
- **Keeping Track of Audit Documents**
- **Auditor Access**

This lesson contains the following topics: Role of the Auditor, Role of the Auditee, Analysis of Evidential Matter, Assertion Process, Types of Audit Reports, Keeping Track of Audit Documents, and Auditor Access.

Let’s begin with the role of the auditors.



Key Point

Role of the Auditor

Overview of the Auditor's Role

It is the auditor's responsibility to:

- **Plan the audit**
- **Obtain relevant information on the effectiveness of your entity's internal control**
- **Conduct tests**
- **Report the results**

GAO/PCIE Financial Audit Manual: http://www.gao.gov

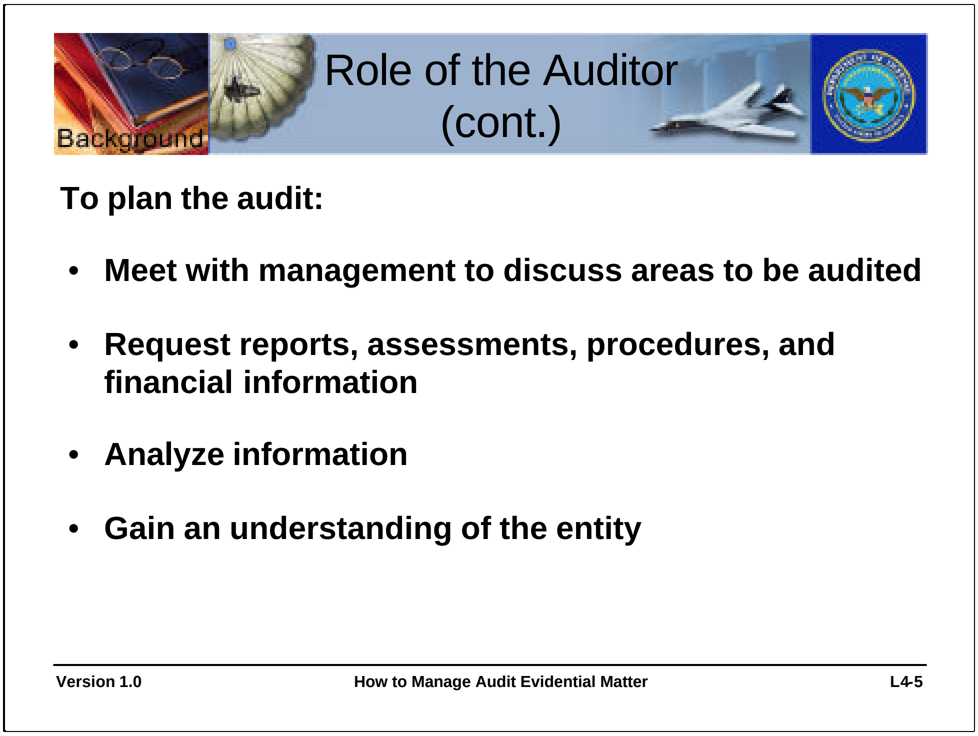
Version 1.0 How to Manage Audit Evidential Matter L4-4

In this topic, you are exposed to what the auditors will request and how data is handled, analyzed, and reported. You will be given an overview of the auditor's role and provided with examples of the processes used.

According to the GAO/PCIE FAM, the overall purposes of performing financial statements audits of federal entities include providing decision-makers (financial statements users) with assurance as to whether the financial statements are reliable, internal control is effective, and laws and regulations are complied with. It is the auditors' responsibility to plan the audit to obtain relevant information on the effectiveness of your entity's internal control and whether your entity complies with requirements of the Federal Financial Management Improvement Act (FFMIA), federal financial management systems requirements, applicable federal accounting standards, and the USSGL at the transaction level.

The auditors then test the significant assertions related to the financial statements and test for compliance with laws and regulations. The auditors then report the results of audit procedures performed.

The auditors begin the audit by gaining a familiarity with your organization and it's operations. Let's examine the types of information that the auditors will request in gaining this understanding.


Background

Role of the Auditor (cont.)

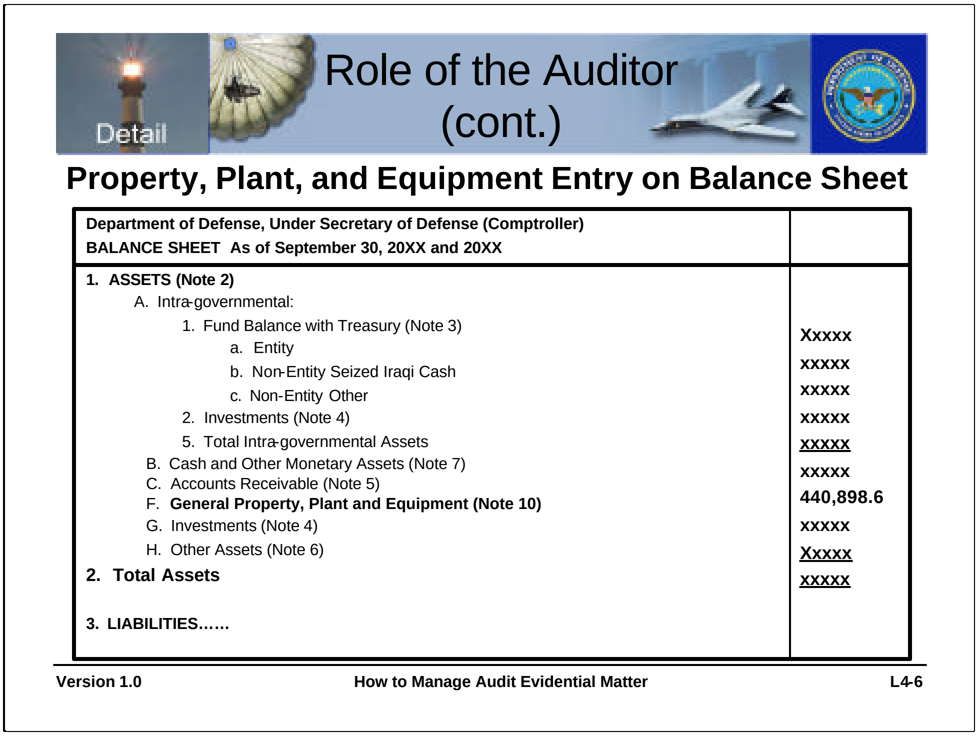
To plan the audit:

- **Meet with management to discuss areas to be audited**
- **Request reports, assessments, procedures, and financial information**
- **Analyze information**
- **Gain an understanding of the entity**

The auditors begin by talking to your management. They discuss the areas to be audited and request various reports, assessments, procedures, and financial information to be analyzed in gaining the required understanding of your entity.

The items may be requested on the PBC list as was covered in the previous lesson. Other items may be supplied as part of an assertion package or may accompany the financial statements.

Let’s look at a few requested items by comparing information as reported on the financial statements to the items requested on a PBC list that the auditors use to gain an understanding of the reported items, starting with an extract of the Property and Equipment area of the Balance Sheet.



Role of the Auditor (cont.)

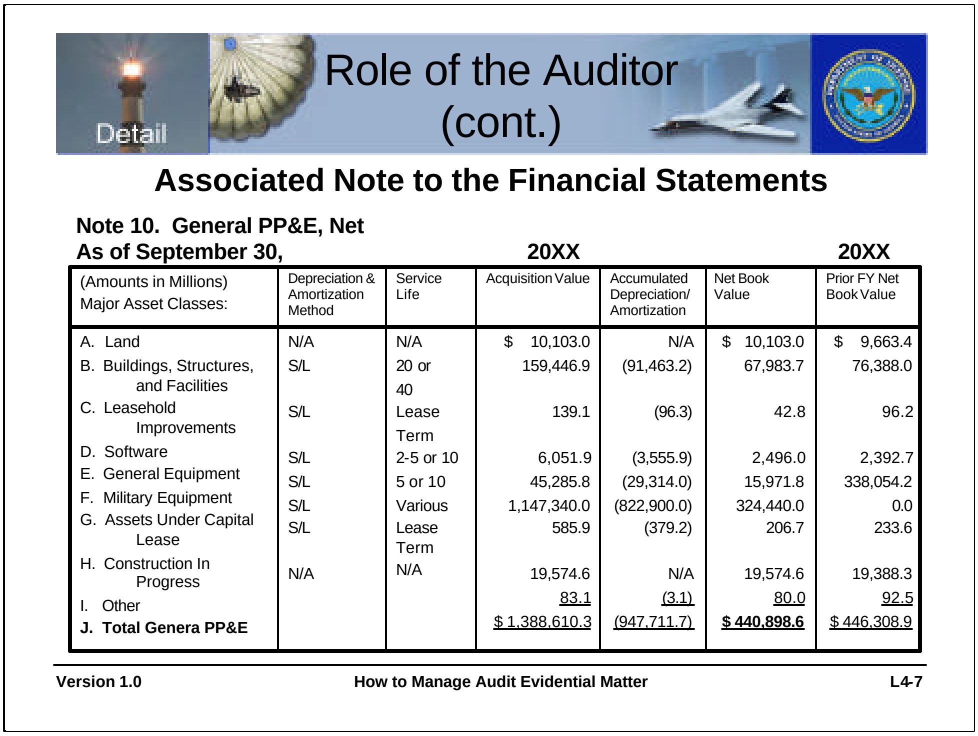
Property, Plant, and Equipment Entry on Balance Sheet

Department of Defense, Under Secretary of Defense (Comptroller) **BALANCE SHEET As of September 30, 20XX and 20XX**	
1. ASSETS (Note 2)	
A. Intra-governmental:	
1. Fund Balance with Treasury (Note 3)	
a. Entity	Xxxxx
b. Non-Entity Seized Iraqi Cash	xxxxx
c. Non-Entity Other	xxxxx
2. Investments (Note 4)	xxxxx
5. Total Intra-governmental Assets	xxxxx
B. Cash and Other Monetary Assets (Note 7)	xxxxx
C. Accounts Receivable (Note 5)	
F. General Property, Plant and Equipment (Note 10)	**440,898.6**
G. Investments (Note 4)	xxxxx
H. Other Assets (Note 6)	Xxxxx
2. Total Assets	xxxxx
3. LIABILITIES……	

Version 1.0 **How to Manage Audit Evidential Matter** **L4-6**

The auditors must determine the reliability of the information that is stated on the financial statements and associated notes. An audit may concern the financial statements as a whole, or it may be limited in scope to one line-item. In this example, we have isolated the General Property, Plant and Equipment line item to illustrate the audit processes.

Notice that this item may be further explained in an associated note to the financial statements. Let's examine Note 10.



Role of the Auditor (cont.)

Associated Note to the Financial Statements

Note 10. General PP&E, Net
As of September 30, 20XX 20XX

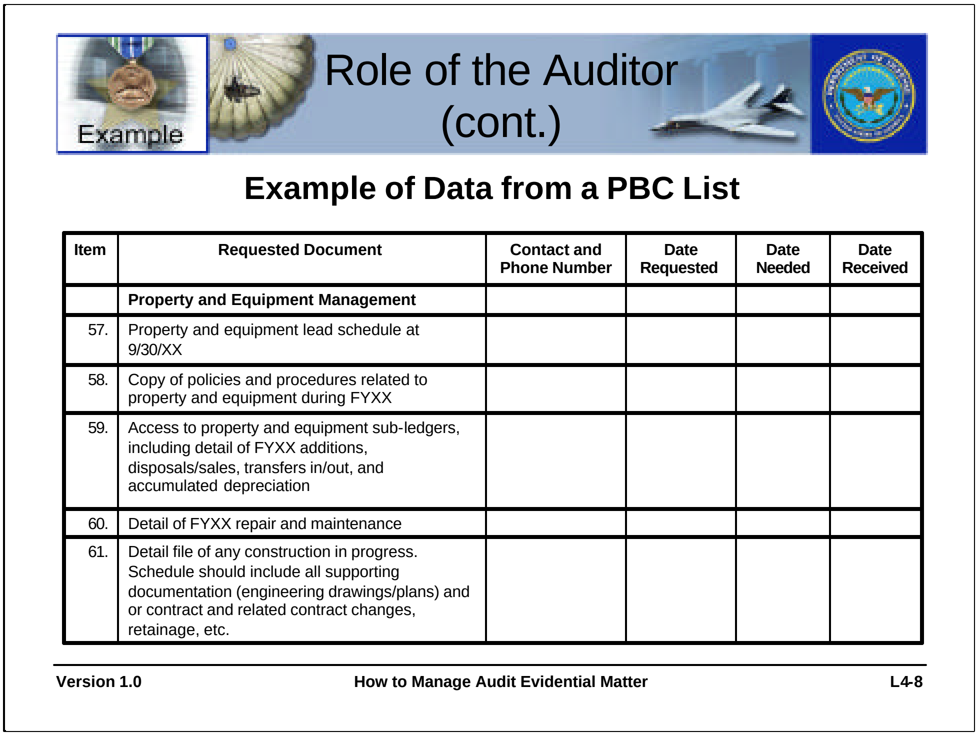
(Amounts in Millions) Major Asset Classes:	Depreciation & Amortization Method	Service Life	Acquisition Value	Accumulated Depreciation/ Amortization	Net Book Value	Prior FY Net Book Value
A. Land	N/A	N/A	$ 10,103.0	N/A	$ 10,103.0	$ 9,663.4
B. Buildings, Structures, and Facilities	S/L	20 or 40	159,446.9	(91,463.2)	67,983.7	76,388.0
C. Leasehold Improvements	S/L	Lease Term	139.1	(96.3)	42.8	96.2
D. Software	S/L	2-5 or 10	6,051.9	(3,555.9)	2,496.0	2,392.7
E. General Equipment	S/L	5 or 10	45,285.8	(29,314.0)	15,971.8	338,054.2
F. Military Equipment	S/L	Various	1,147,340.0	(822,900.0)	324,440.0	0.0
G. Assets Under Capital Lease	S/L	Lease Term	585.9	(379.2)	206.7	233.6
H. Construction In Progress	N/A	N/A	19,574.6	N/A	19,574.6	19,388.3
I. Other			83.1	(3.1)	80.0	92.5
J. Total Genera PP&E			$ 1,388,610.3	(947,711.7)	**$ 440,898.6**	$ 446,308.9

Version 1.0 **How to Manage Audit Evidential Matter** **L4-7**

Note 10. General PP&E, Net, provides a break-down of the classes of property, plant, and equipment that form the Net Book Value as reported on the financial statements. Within this break-down are the calculations of depreciation and amortization for each class of PP&E.

The auditors will determine whether the method of calculation is appropriate for the class of asset and whether there is sufficient evidence to support the ownership, transfer, sale, or purchase of each asset.

To do this, the auditors must request supporting information for each item to be evaluated. This information is requested on a PBC list. Let’s look at the items requested to support property and equipment management.



Role of the Auditor (cont.)

Example of Data from a PBC List

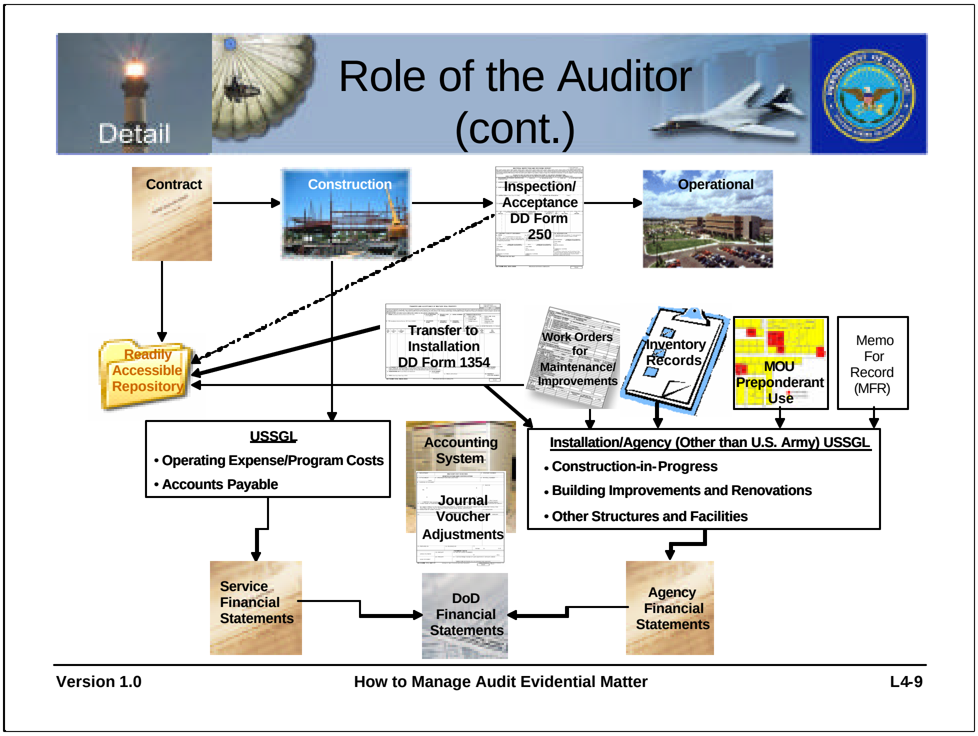
Item	Requested Document	Contact and Phone Number	Date Requested	Date Needed	Date Received
	Property and Equipment Management				
57.	Property and equipment lead schedule at 9/30/XX				
58.	Copy of policies and procedures related to property and equipment during FYXX				
59.	Access to property and equipment sub-ledgers, including detail of FYXX additions, disposals/sales, transfers in/out, and accumulated depreciation				
60.	Detail of FYXX repair and maintenance				
61.	Detail file of any construction in progress. Schedule should include all supporting documentation (engineering drawings/plans) and or contract and related contract changes, retainage, etc.				

Version 1.0 How to Manage Audit Evidential Matter L4-8

Notice that item number 59 requests access to property and equipment sub-ledgers, including detail of the affected years' additions, disposals or sales, transfers in and out, and accumulated depreciation.

In requesting these items, the auditors are gathering the information required to compare changes in property amounts from one period to the next. In previous entries to the PBC list, shown in Lesson 3, the auditors requested process analysis, policies, procedures, schedules, and accounts. These items are used to gain an understanding of how your entity classifies and accounts for any property and equipment it owns.

Let's illustrate how the auditors may use this information.



Detail

Role of the Auditor (cont.)

Contract

Construction

Inspection/ Acceptance DD Form 250

Operational

Readily Accessible Repository

Transfer to Installation DD Form 1354

Work Orders for Maintenance/ Improvements

Inventory Records

MOU Preponderant Use

Memo For Record (MFR)

USSGL
- Operating Expense/Program Costs
- Accounts Payable

Accounting System

Journal Voucher Adjustments

Installation/Agency (Other than U.S. Army) USSGL
- Construction-in-Progress
- Building Improvements and Renovations
- Other Structures and Facilities

Service Financial Statements

DoD Financial Statements

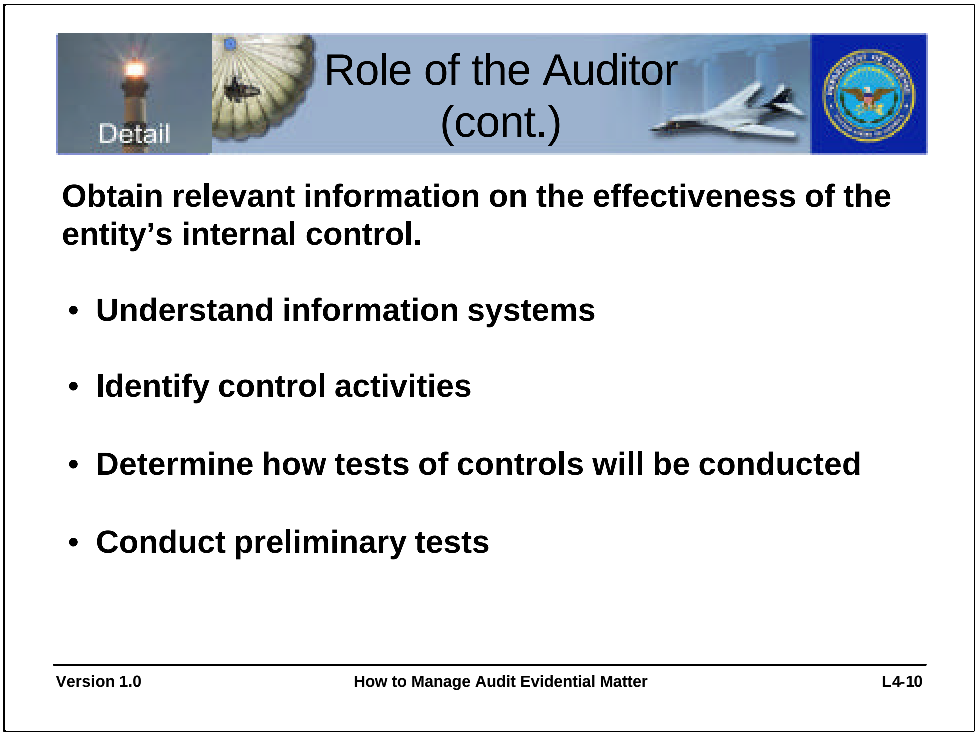
Agency Financial Statements

Version 1.0 How to Manage Audit Evidential Matter L4-9

In this example, your entity describes the process by which a construction project interfaces with the various accounting and property management systems, and how those systems eventually report the property into the financial statements. Using this description, the auditors examine the property records you supplied to determine whether there is sufficient information to verify the amounts reported on the financial statements and related notes, or whether more detail is required.

Once the auditor obtains a sufficient understanding of the transaction detail, the auditors will attempt to obtain relevant information on the effectiveness of your entity's internal control.

Let's discuss this process.



Role of the Auditor (cont.)

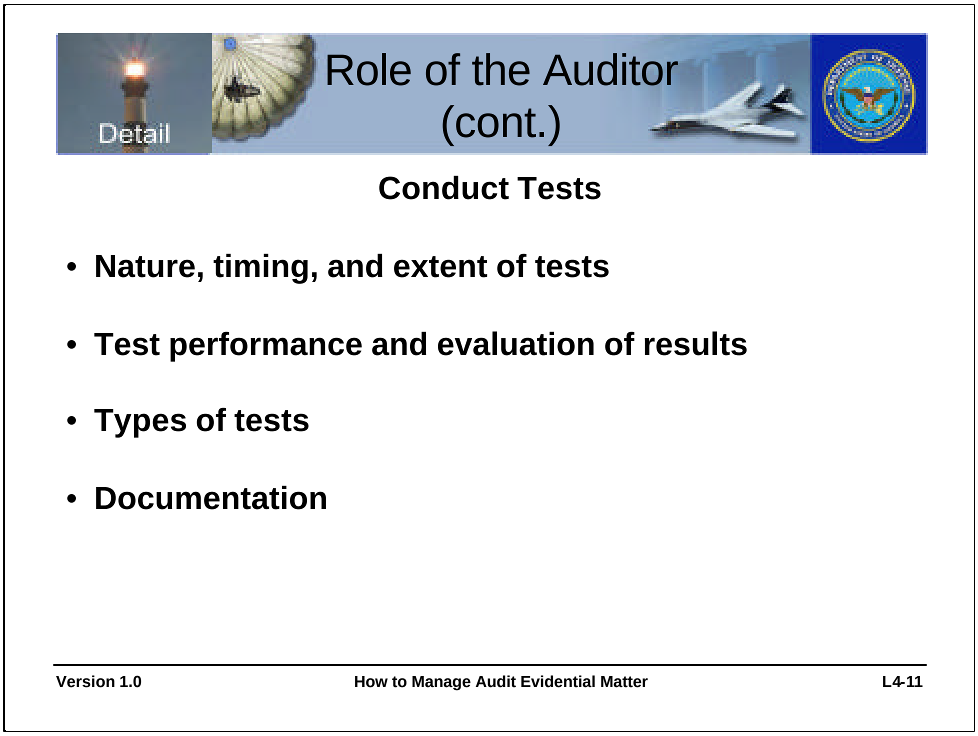
Obtain relevant information on the effectiveness of the entity’s internal control.

- **Understand information systems**
- **Identify control activities**
- **Determine how tests of controls will be conducted**
- **Conduct preliminary tests**

In obtaining relevant information on the effectiveness of your entity’s internal control, the auditors examine the flow of data into and out of your information systems. Control activities such as password usage, separation of duties, and system access are examined to assess the vulnerability of your information systems on a preliminary basis.

Other control activities that may be examined are paperwork processes, signature authorizations, and security of physical assets among many others.

The auditors then determine how each area may be most efficiently and effectively tested to ensure that it is in compliance with established guidance or whether established guidance is sufficient to protect the item. The auditors conduct preliminary tests to determine the reliability of the test design. Let’s look at the testing process.



Detail

Role of the Auditor (cont.)

Conduct Tests

- **Nature, timing, and extent of tests**
- **Test performance and evaluation of results**
- **Types of tests**
- **Documentation**

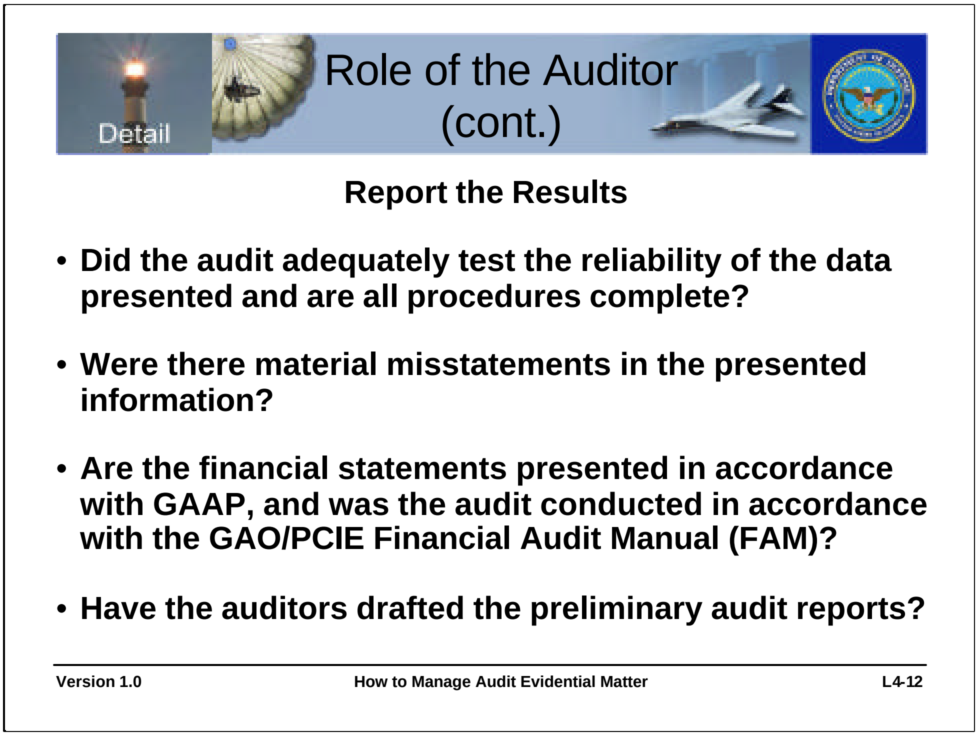
Version 1.0 How to Manage Audit Evidential Matter L4-11

In conducting tests, the auditors considers the nature, timing, and extent of testing that is required to sufficiently determine whether the information reported on the financial statements and related notes is reliable, whether your entity's internal controls are effective, and whether laws and regulations are complied with. Risk assessment determines the level of tests.

At this point, the auditors request details of specific transactions, interview personnel on processes and procedures, and examine systems controls. Once the transaction data is received, the auditors conduct specific tests, evaluate results, and document the process. You explored these processes in Lesson 1, Producing Audit Evidential Matter.

The auditors report the results of the audit when sufficient evidence to support an opinion is obtained.

Let's consider this process.



Detail

Role of the Auditor (cont.)

Report the Results

- **Did the audit adequately test the reliability of the data presented and are all procedures complete?**
- **Were there material misstatements in the presented information?**
- **Are the financial statements presented in accordance with GAAP, and was the audit conducted in accordance with the GAO/PCIE Financial Audit Manual (FAM)?**
- **Have the auditors drafted the preliminary audit reports?**

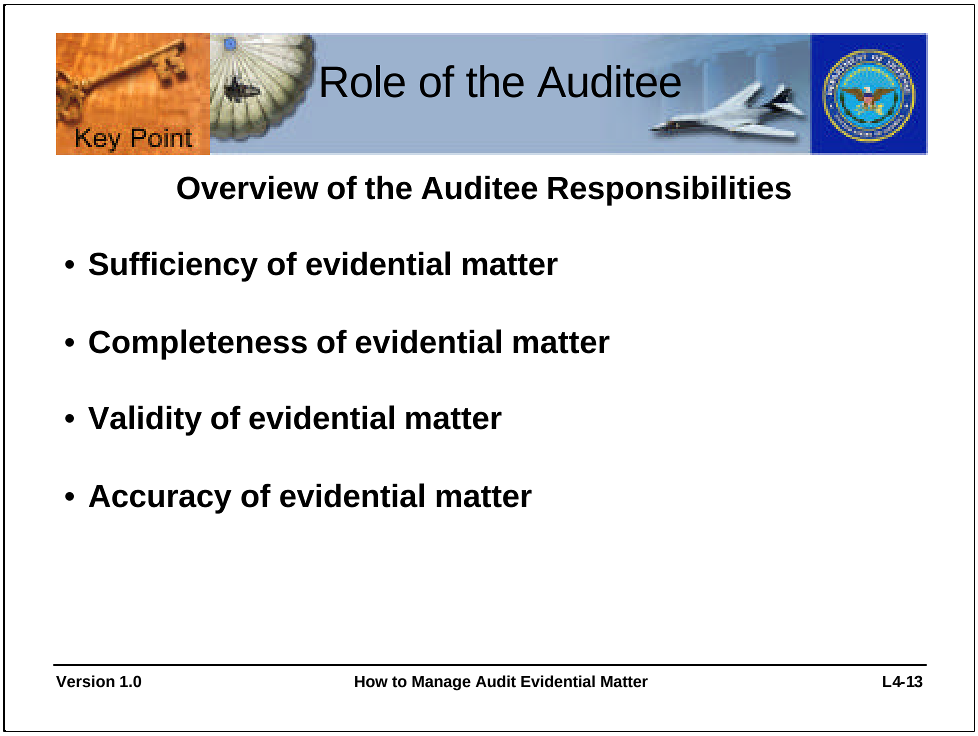
In reporting the results, the auditors perform overall analytical procedures to determine whether the tests were sufficient to form the basis for an opinion. Procedures are reviewed to ensure that any items that were awaiting action have been completed.

The auditors may have encountered errors on the reported data or in the procedures followed. The auditors may propose adjustments to correct the errors. The auditors must determine whether those errors are material to the financial statements, internal control, or compliance with laws and regulations. The auditors also determine whether there were material departures from GAAP in the presentation of financial information and the conduct of accounting for financial transactions.

The GAO/PCIE FAM describes the processes for the performance of financial statements audits of federal entities. It describes how the methodology relates to relevant auditing and attestation standards and OMB guidance. It also outlines key issues to be considered in using the methodology.

The auditors meet with management at the end of the audit to discuss the results of the audit. Drafts of the audit reports are used to provide a format for discussion and to ensure that management has a chance to address any outstanding issues that will eventually be reported within the audit reports.

Now let’s look at the role of the auditee.



Key Point

Role of the Auditee

Overview of the Auditee Responsibilities

- **Sufficiency of evidential matter**
- **Completeness of evidential matter**
- **Validity of evidential matter**
- **Accuracy of evidential matter**

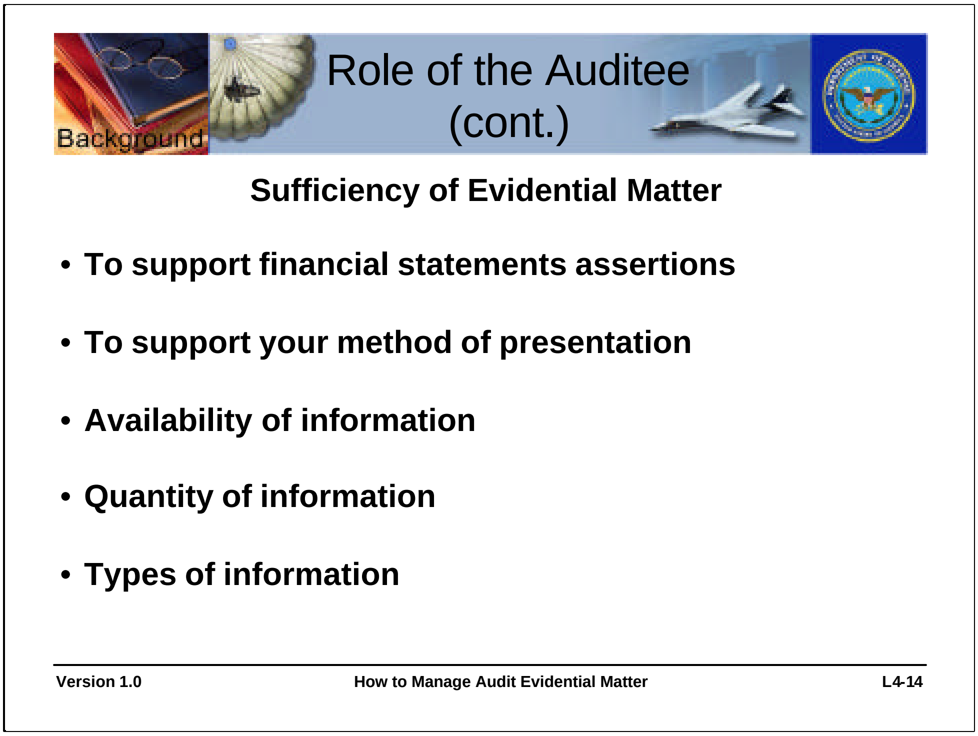
Version 1.0 How to Manage Audit Evidential Matter L4-13

In this topic, you are exposed to the role of the auditee in providing sufficient, complete, valid, and accurate evidential matter. Evidential matter and its presentation must be both convincing and persuasive.

Evidential matter includes journal entries, general and subsidiary ledgers, related accounting manuals, and informal and memorandum records such as worksheets supporting cost allocations, computations, and reconciliations. It also includes corroborating evidence that supports transactions recorded in the journals and ledgers.

Documentation should be readily available and accessible to the auditors.

Let’s consider what is meant by the sufficiency of evidential matter.



Background

Role of the Auditee (cont.)

Sufficiency of Evidential Matter

- **To support financial statements assertions**
- **To support your method of presentation**
- **Availability of information**
- **Quantity of information**
- **Types of information**

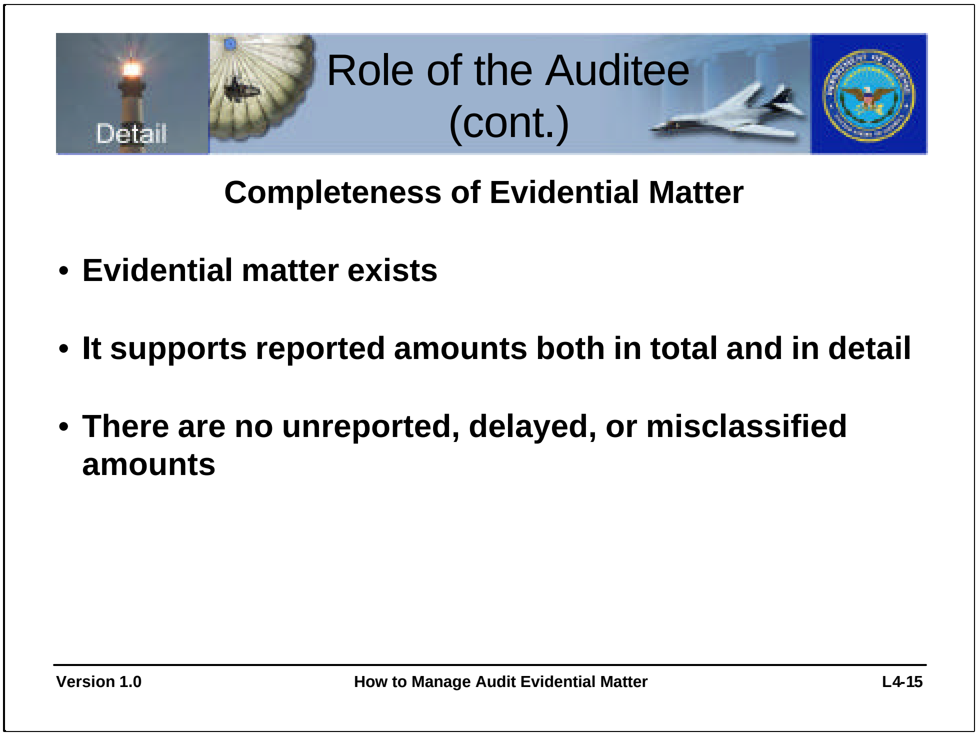
Version 1.0 How to Manage Audit Evidential Matter L4-14

To be sufficient, the amount of readily available evidence must be enough to support your explicit or implied assertions that the information as reported on the financial statements and accompanying notes is based on the existence or occurrence of financial transactions, that those transactions are complete, that the valuation or allocation of the amounts is accurately calculated, that you have a right to the assets reported, and that the obligations are accurate and complete. Sufficient evidence must also be available to support your method of presentation of the financial information and other disclosures. This information is presented in the notes to the financial statements.

The auditors must have access to documents that you have prepared as well as work prepared by consultants. The auditors require access to corroborating information to support the reported information. For PP&E, this corroborating information may include property deeds, sale or transfer documents, construction contracts, leases, receiving reports, surveys, inventory records, and many other documents.

The auditors make a determination on the quantity and types of information required based on the effectiveness of the internal control of your organization and on the importance of the reported information. Evidential matter is obtained through inspection, observation, inquiry, and confirmation.

Now let’s discuss the completeness of evidential matter.



Role of the Auditee (cont.)

Completeness of Evidential Matter

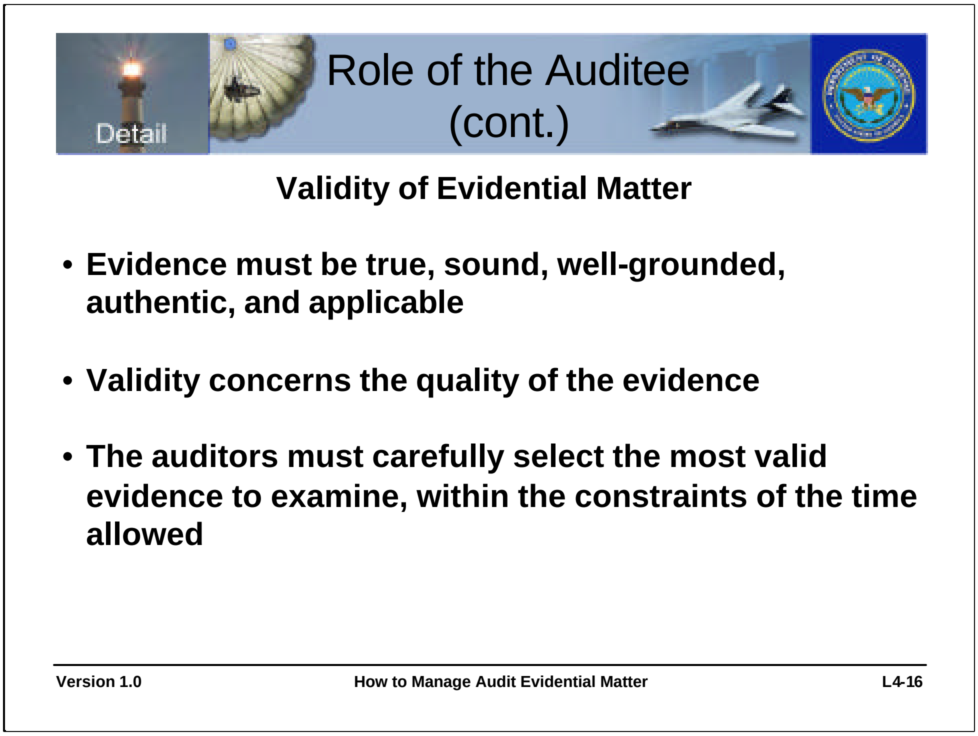
- **Evidential matter exists**
- **It supports reported amounts both in total and in detail**
- **There are no unreported, delayed, or misclassified amounts**

Version 1.0 How to Manage Audit Evidential Matter L4-15

To be complete, evidential matter must exist to support the reported information. You must ensure that there is underlying accounting information and documentation to support the reported amounts both in total and in detail. You must also ensure that all valid transactions are recorded and properly classified. All economic events that occurred in the current period should have been recorded in the current period. You must determine whether all accounts that belong in the financial statements are included, and that there are no undisclosed assets or liabilities.

An example of completeness is that the amount reported as accounts payable represents all amounts owed by the entity that should be classified as an account payable, and that there are no unreported accounts payable. Complete evidential matter would support the fact that all reported accounts payable can be supported with sufficient detail, and that there are no unreported, delayed, or misclassified accounts payable. This requires proactive measures to ensure that supporting information that affects the financial information is identified as financial data and treated accordingly. These measures may include adjustments of periodic inventory times, longer file retention times, additional systems controls, and other measures.

Now you must determine the validity of your evidential matter.



Detail

Role of the Auditee (cont.)

Validity of Evidential Matter

- **Evidence must be true, sound, well-grounded, authentic, and applicable**
- **Validity concerns the quality of the evidence**
- **The auditors must carefully select the most valid evidence to examine, within the constraints of the time allowed**

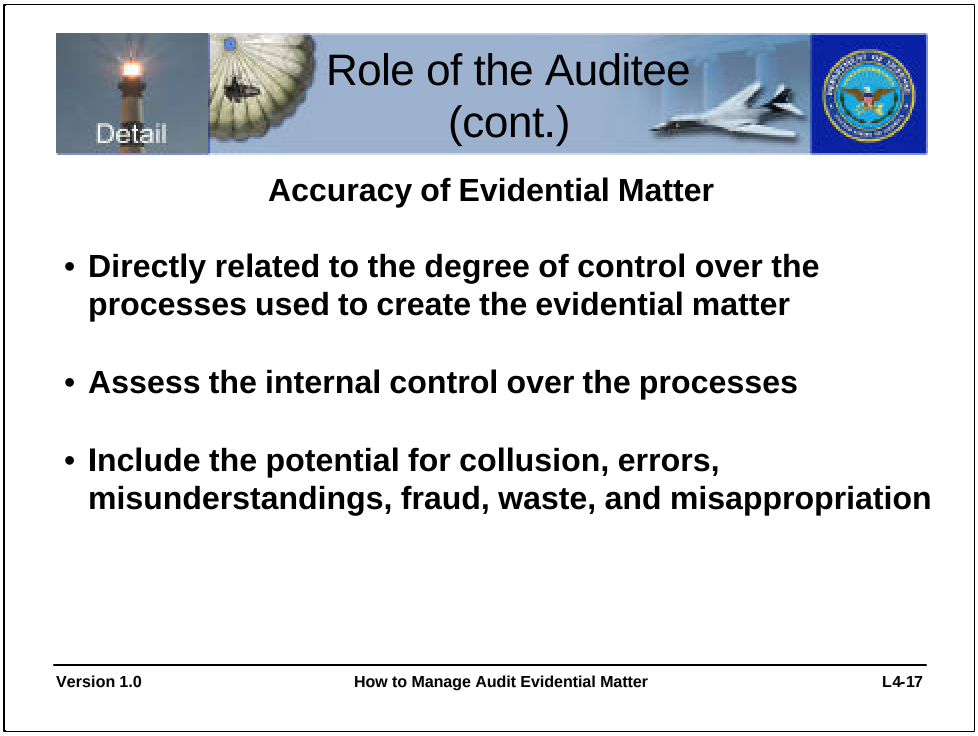
Version 1.0 **How to Manage Audit Evidential Matter** **L4-16**

Auditors must make a determination on the fairness of the financial statements based on the examination of limited amounts of evidence. That evidence must be true, sound, authentic, well grounded, and applicable to the facts being represented. It must be obtained from a credible source and developed under an effective control system.

Validity of evidential matter concerns the quality of the evidence. In Lesson 1, Producing Audit Evidential Matter, you learned that primary evidentiary matter is information at the highest level of evidence. This category may include checks, time cards, contracts, invoices, receiving reports, and vouchers. You may notice that these documents represent original documentation; they may contain signatures, dates, and date stamps; and they may have passed through an outside entity such as a bank or independent supplier or contractor. This evidence is also the most difficult to produce and examine in a timely manner. You also learned that secondary evidentiary matter is often reliable but not always assumed to be correct. It may include spreadsheets prepared by your entity and calculations that you have performed. This evidence is more easily obtained and provides a summary of information that the auditors may independently test or recalculate.

As an audit is a trade-off between the examination of evidence and the time expended in the effort of that examination, the auditors must choose carefully the most valid evidence to examine to ensure that the financial statements are presented fairly. You must ensure that you are able to obtain evidential matter to support those transactions and balances that are important to the fair representation of your entity.

Now let's examine the accuracy of evidential matter.



Role of the Auditee (cont.)

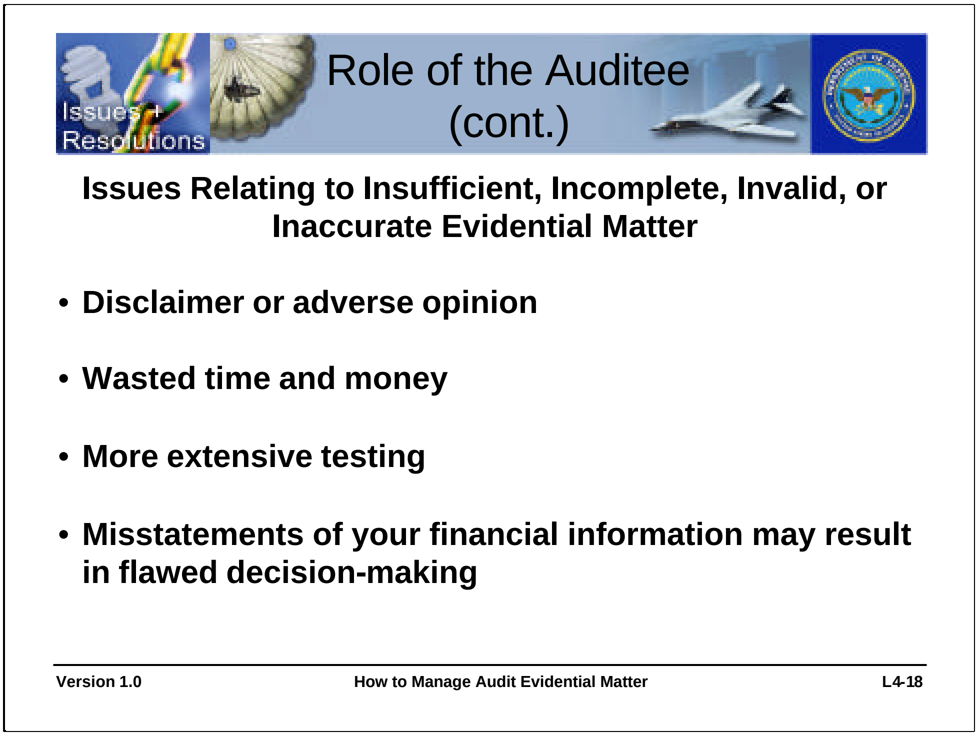
Accuracy of Evidential Matter

- **Directly related to the degree of control over the processes used to create the evidential matter**
- **Assess the internal control over the processes**
- **Include the potential for collusion, errors, misunderstandings, fraud, waste, and misappropriation**

The apparent accuracy of evidential matter is directly related to the degree of control over the processes used in the creation of that evidential matter. You must assess the internal control procedures used within each transaction cycle to evaluate the degree to which the information provided by these processes is accurate.

You must assess your internal control to include the possibility of management override, collusion, errors due to fatigue or misunderstandings of requirements, and physical controls including periodic inventories and security measures.

Let’s look at issues related to insufficient, incomplete, invalid, or inaccurate evidential matter.


Issues + Resolutions

Role of the Auditee (cont.)

Issues Relating to Insufficient, Incomplete, Invalid, or Inaccurate Evidential Matter

- **Disclaimer or adverse opinion**
- **Wasted time and money**
- **More extensive testing**
- **Misstatements of your financial information may result in flawed decision-making**

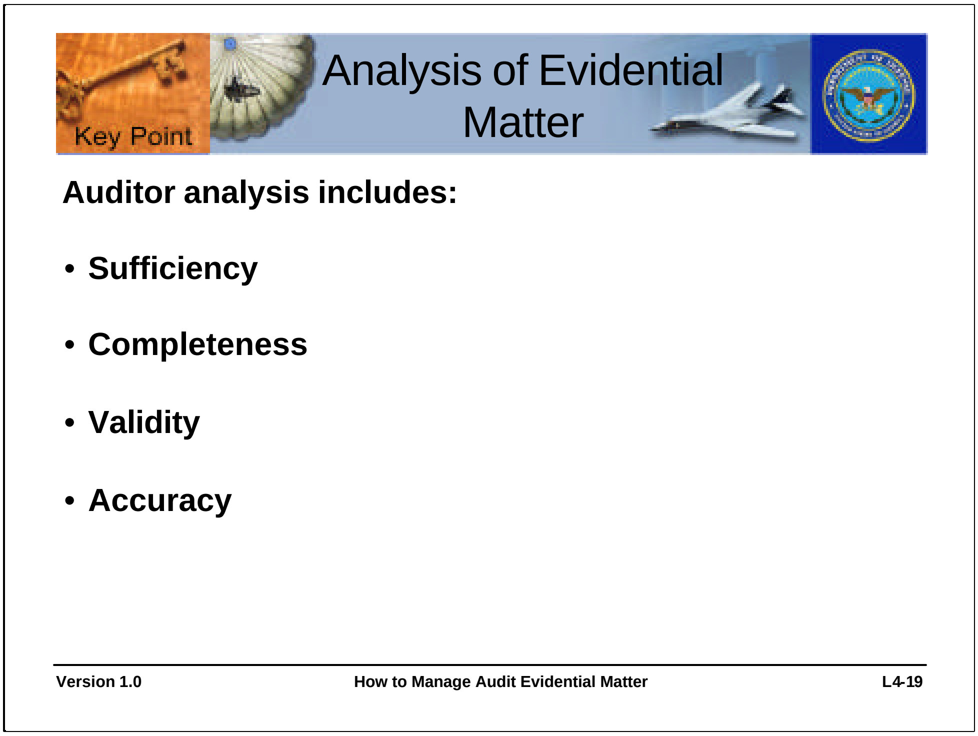
Insufficient evidential matter or failure to produce the required evidential matter in a timely manner denies the auditors the evidence to form an opinion on your financial statements. This may result in a disclaimer of opinion with the result that the effort expended on the audit becomes a wasted effort in terms of both time and money.

Incomplete evidential matter provides just enough evidence to show that the transaction may exist, but you may not be able to trace the transaction to its source. It results in more extensive testing by the auditors to determine whether this is a pervasive or system problem, or whether it is associated with a single event or cycle. This additional testing costs more, and may still result in a disclaimer of opinion if enough evidence cannot be obtained to substantiate the reported information.

Invalid evidential matter does not test or substantiate those transactions and balances that are important to the fair representation of your entity. The auditors will request more appropriate substantiating evidence.

Inaccurate evidential matter is the result of one or more failures in your internal controls. The auditors will attempt to determine the affected control, again at the expense of time and effort. Inaccurate evidential matter results in misstatements of the financial information that your organization has reported and results in an adverse opinion on the audit of your financial statements. Misstatements of significant amounts may result in flawed decision-making by management.

Let's look at some analytical processes that will assist you in providing better evidential matter.



Key Point

Analysis of Evidential Matter

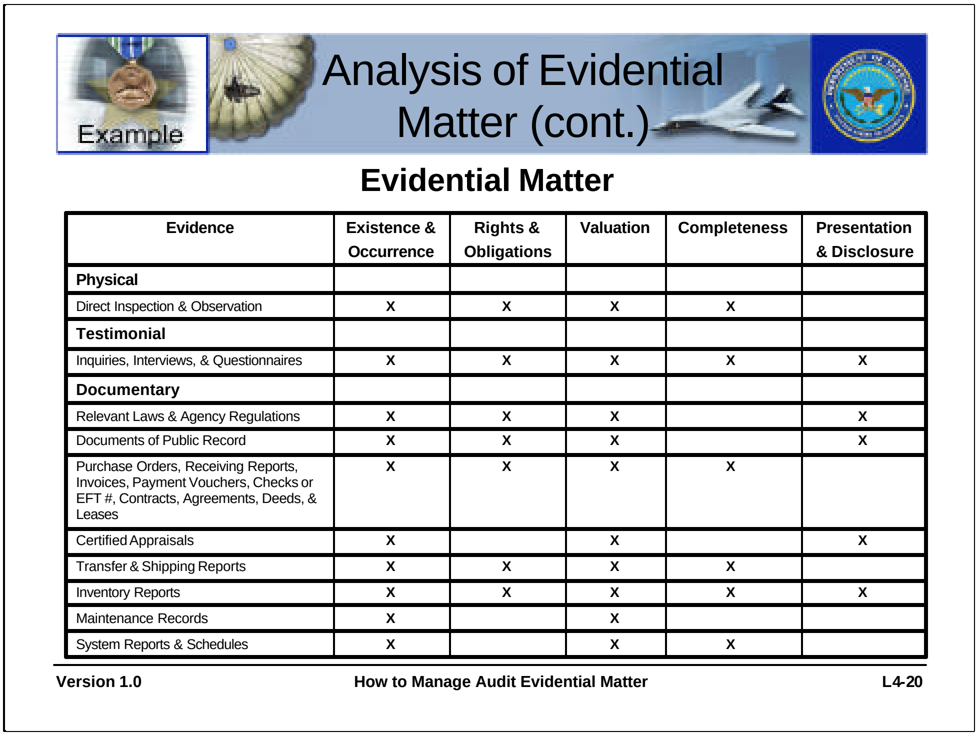
Auditor analysis includes:

- **Sufficiency**
- **Completeness**
- **Validity**
- **Accuracy**

Version 1.0 How to Manage Audit Evidential Matter L4-19

In this topic, you are exposed to the various types of analysis used to ensure that the evidential matter is sufficient, complete, valid, and accurate. Analytical procedures are designed to test a specific assertion or multiple assertions. To ensure that you are able to provide the auditors with the required evidential matter in the appropriate amount, form, detail, and accuracy, it is helpful to understand the procedures that the auditors use to inspect and analyze the information represented by your financial statements.

Let's illustrate these processes beginning with an overview of the analysis of evidential matter.



Analysis of Evidential Matter (cont.)

Evidential Matter

Evidence	Existence & Occurrence	Rights & Obligations	Valuation	Completeness	Presentation & Disclosure
Physical					
Direct Inspection & Observation	X	X	X	X	
Testimonial					
Inquiries, Interviews, & Questionnaires	X	X	X	X	X
Documentary					
Relevant Laws & Agency Regulations	X	X	X		X
Documents of Public Record	X	X	X		X
Purchase Orders, Receiving Reports, Invoices, Payment Vouchers, Checks or EFT #, Contracts, Agreements, Deeds, & Leases	X	X	X	X	
Certified Appraisals	X		X		X
Transfer & Shipping Reports	X	X	X	X	
Inventory Reports	X	X	X	X	X
Maintenance Records	X		X		
System Reports & Schedules	X		X	X	

Version 1.0 **How to Manage Audit Evidential Matter** **L4-20**

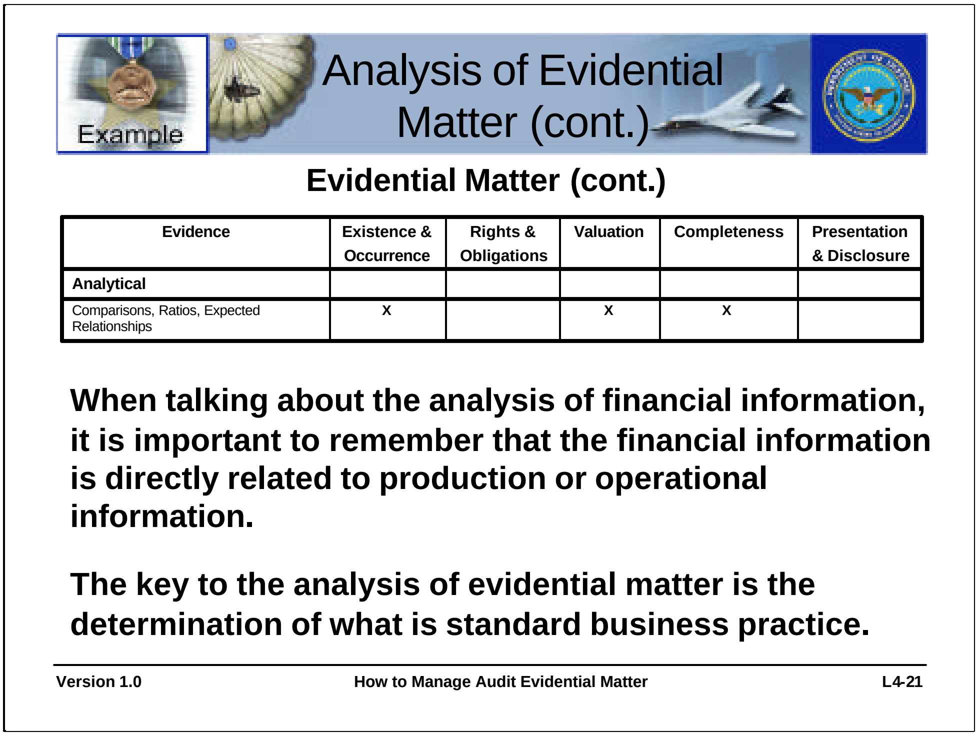
To analyze physical evidence such as the location of a particular piece of property or the features of a system, the auditors actually observe or inspect the property or system. To ensure that you are able to provide evidence to substantiate the existence of your property, you may elect to examine on a test basis that the property that exists in your records system also exists at the physical location that it has been assigned. The auditors examine the physical condition of the property and any accompanying records to ensure that its value as stated is reasonable, and that your entity has a right to ownership or use of the property. The auditors may examine adjacent property to ensure that it is accurately recorded as well.

Testimonial evidence may be used to test any or all of the financial statements' assertions. The auditors conduct interviews of selected personnel to ensure that proper procedures are being followed. The auditors may provide questionnaires to test the control climate, attitude toward ethics, and employee understanding of policies or procedures. The auditors may inquire about account balances or unusual activities. You can be prepared with up-to-date training on current policies and procedures, and a management emphasis on ethical conduct.

The auditors examine all kinds of documentation, as you can see on this chart. The auditors examine relevant laws and agency regulations to understand the constraints under which you must operate. You must also understand the laws and regulations that apply to the way you operate to ensure your compliance.

Notice that the type of evidence and the method used to audit that evidence is related to the assertion that must be proved. Now notice that the examination of purchase orders, invoices, or contracts may prove the existence and occurrence of a transaction, rights or obligations to property or debt, value of goods sold or received, and completeness of an accounting event, but they do not prove the method by which the transaction must be presented or disclosed on the financial statements. By examining these documents and others, the auditors attempt to prove on a sample basis that the amounts reported on your financial records are based on factual data.

Let's continue with a look at evidence of an analytical nature.



Analysis of Evidential Matter (cont.)

Evidential Matter (cont.)

Evidence	Existence & Occurrence	Rights & Obligations	Valuation	Completeness	Presentation & Disclosure
Analytical					
Comparisons, Ratios, Expected Relationships	X		X	X	

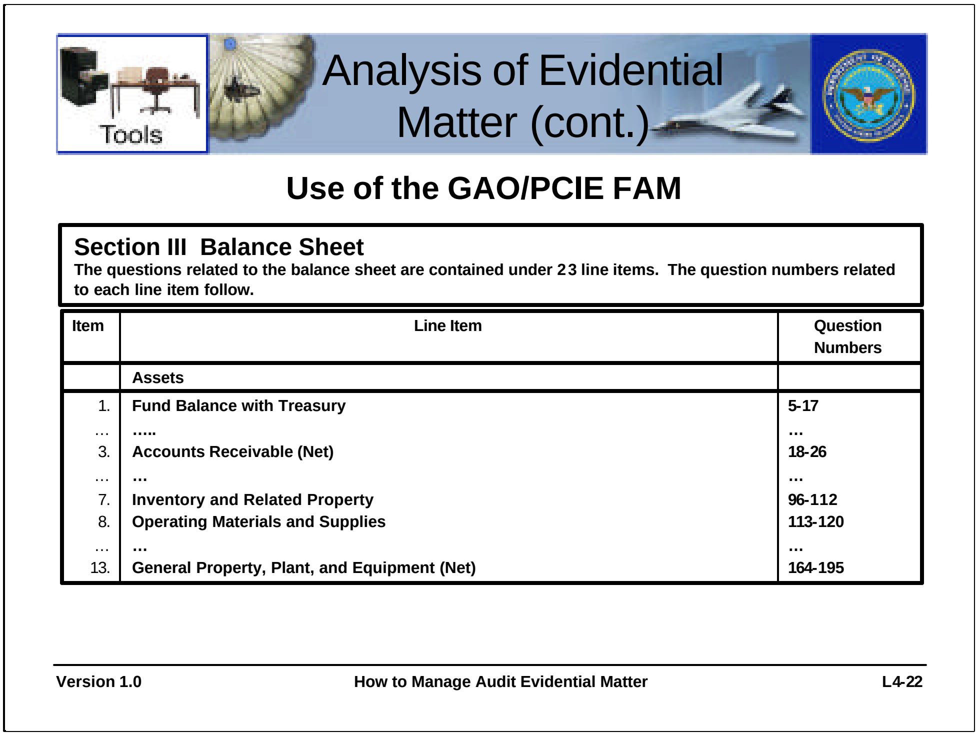
When talking about the analysis of financial information, it is important to remember that the financial information is directly related to production or operational information.

The key to the analysis of evidential matter is the determination of what is standard business practice.

Evidence includes spreadsheets, reports, calculations, and other information that is prepared for the purpose of consolidating account balances, calculating depreciation or amortization, estimating costs, calculating interest, estimating benefits, or any purpose that affects the presentation of financial information. The auditors may recalculate amounts based on authorized methods of calculating for the type of information presented. The auditors may compare amounts to expected values, calculate ratios, look at relationships of data, and analyze those relationships.

When talking about the analysis of financial information, it is important to remember that the financial information is directly related to production or operational information. An example is the maintenance or repair cost associated with property, plant, or equipment. The auditors may compare repair and maintenance expense amounts to changes in property, plant, or equipment amounts or increases or decreases in operational tempo. An abnormal result such as an extreme decrease in the ratio of repairs expense to the property, plant, or equipment turnover rate may indicate that some maintenance expenditures have not been recorded or that they have been capitalized in error. The reverse may also be true where an extreme increase in maintenance expenditures may indicate that expenditures that result in upgraded capability or increased capacity over the threshold amount may have been expensed instead of capitalized. The key to the analysis of evidential matter is the determination of what is standard business practice.

Let's look at how you can use the auditors' tools to analyze the evidence.



Analysis of Evidential Matter (cont.)

Use of the GAO/PCIE FAM

Section III Balance Sheet

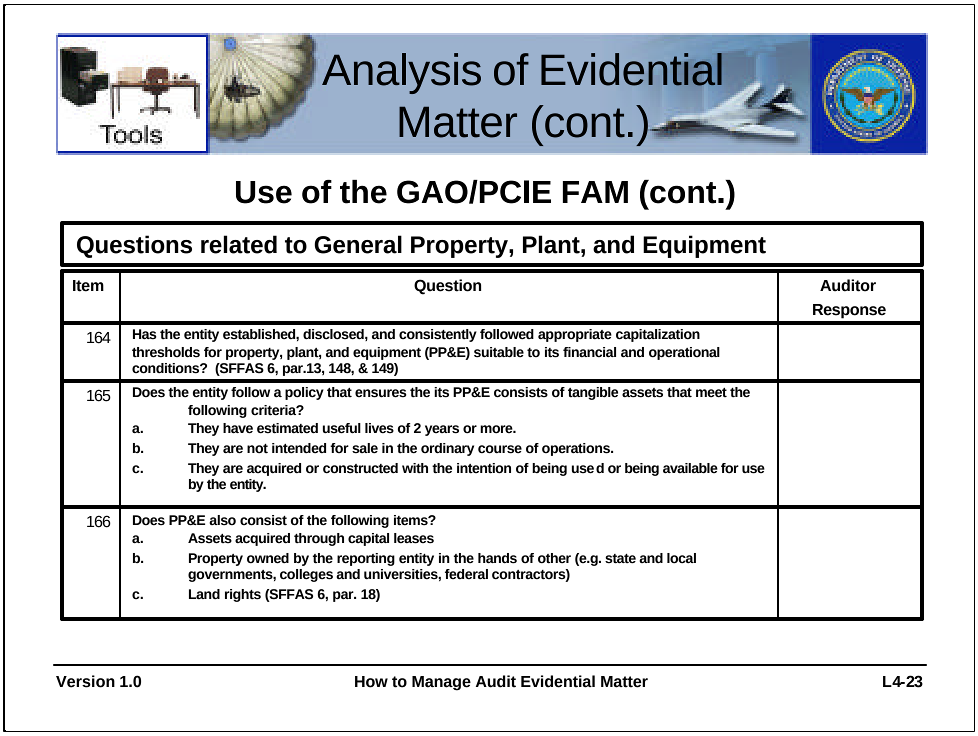
The questions related to the balance sheet are contained under 23 line items. The question numbers related to each line item follow.

Item	Line Item	Question Numbers
	Assets	
1.	**Fund Balance with Treasury**	**5-17**
…	**…..**	**…**
3.	**Accounts Receivable (Net)**	**18-26**
…	**…**	**…**
7.	**Inventory and Related Property**	**96-112**
8.	**Operating Materials and Supplies**	**113-120**
…	**…**	**…**
13.	**General Property, Plant, and Equipment (Net)**	**164-195**

Using the GAO/PCIE FAM, the auditors obtain answers to questions concerning the financial statements' assertions. That checklist of questions may be used as a tool in analyzing your evidential matter in preparation for an audit. It includes sections on compliance with legislative requirements, intra-governmental transactions, management representations, and financial reports prepared under the Chief Financial Officers (CFO) Act.

It is the area of financial reports prepared under the CFO Act where you find audit questions related to the Balance Sheet. General Property, Plant, and Equipment is represented by question numbers 164 through 195.

Let's examine a few of these questions.



Analysis of Evidential Matter (cont.)

Use of the GAO/PCIE FAM (cont.)

Questions related to General Property, Plant, and Equipment

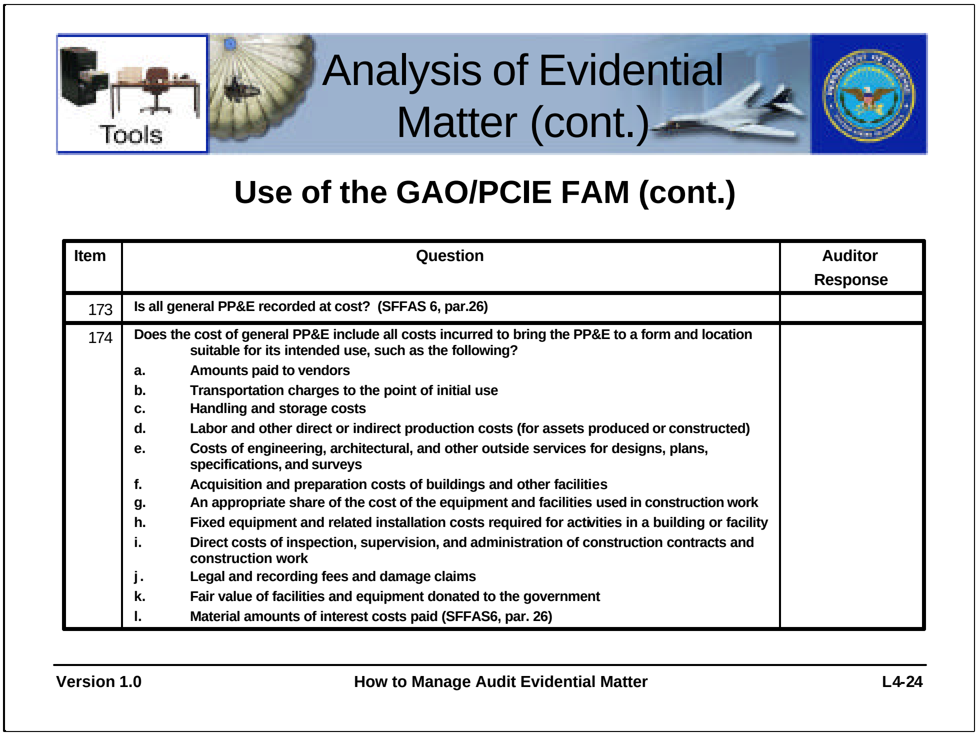
Item	Question	Auditor Response
164	Has the entity established, disclosed, and consistently followed appropriate capitalization thresholds for property, plant, and equipment (PP&E) suitable to its financial and operational conditions? (SFFAS 6, par.13, 148, & 149)	
165	Does the entity follow a policy that ensures the its PP&E consists of tangible assets that meet the following criteria? a. They have estimated useful lives of 2 years or more. b. They are not intended for sale in the ordinary course of operations. c. They are acquired or constructed with the intention of being used or being available for use by the entity.	
166	Does PP&E also consist of the following items? a. Assets acquired through capital leases b. Property owned by the reporting entity in the hands of other (e.g. state and local governments, colleges and universities, federal contractors) c. Land rights (SFFAS 6, par. 18)	

Version 1.0 How to Manage Audit Evidential Matter L4-23

In examining the first few questions, we notice that they pertain to the composition of items to be reported within the category General PP&E. You may analyze how your PP&E are initially classified to ensure that they are entered correctly into the accounting systems. You may review your procedures to ensure that the proper classification of your PP&E is a part of your internal control over the acquisition and improvement of these assets.

Notice that after questions 164 and 166, reference is made to the SFFAS Number 6, Accounting for Property, Plant, and Equipment. By reading the designated paragraphs of the standard you may obtain further explanation of the standard being assessed by the audit that generated the question on the checklist. For example, paragraph 13 deals with capitalization thresholds, and paragraph 18 deals with definitions.

Let’s look at a couple more questions.



Analysis of Evidential Matter (cont.)

Use of the GAO/PCIE FAM (cont.)

Item	Question	Auditor Response
173	Is all general PP&E recorded at cost? (SFFAS 6, par.26)	
174	Does the cost of general PP&E include all costs incurred to bring the PP&E to a form and location suitable for its intended use, such as the following? a. Amounts paid to vendors b. Transportation charges to the point of initial use c. Handling and storage costs d. Labor and other direct or indirect production costs (for assets produced or constructed) e. Costs of engineering, architectural, and other outside services for designs, plans, specifications, and surveys f. Acquisition and preparation costs of buildings and other facilities g. An appropriate share of the cost of the equipment and facilities used in construction work h. Fixed equipment and related installation costs required for activities in a building or facility i. Direct costs of inspection, supervision, and administration of construction contracts and construction work j. Legal and recording fees and damage claims k. Fair value of facilities and equipment donated to the government l. Material amounts of interest costs paid (SFFAS6, par. 26)	

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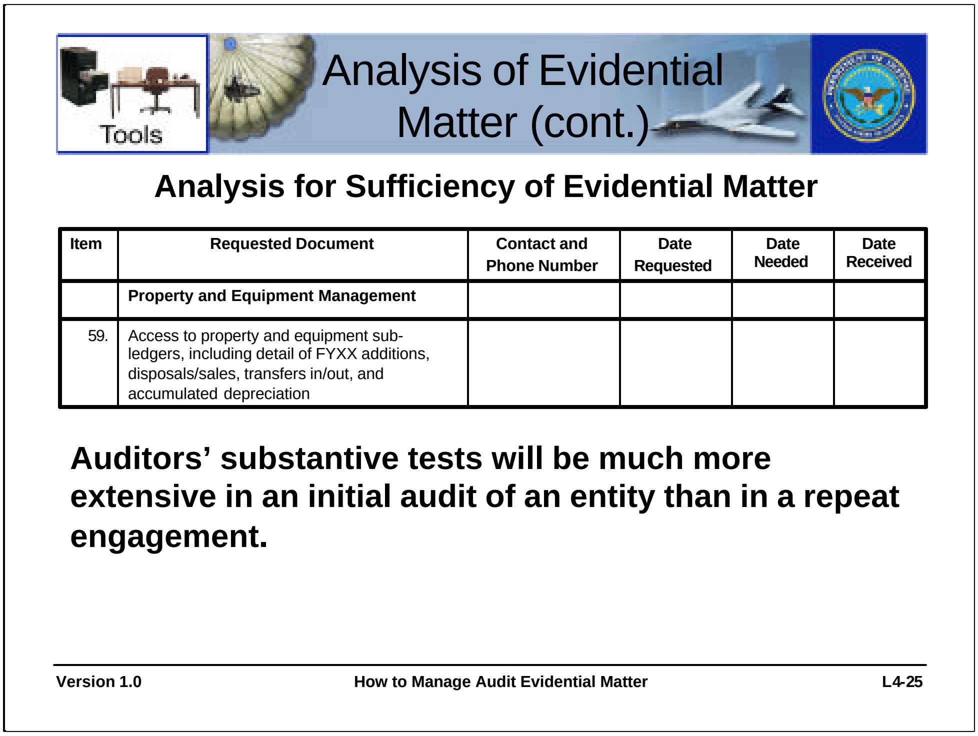
In examining these questions, we notice that they concern elements of cost associated with bringing the PP&E into a useable form and location. In order to accurately answer question 173, it is necessary to understand the elements of cost that must be considered and are annotated in question 174.

When using this tool to analyze your evidential documentation, you must read all of the questions that concern the area being asserted as they work in-concert with each other.

In looking at question 174, you must consider that the auditors may have to examine a considerable amount of documentation to form an opinion on the sufficiency, completeness, validity, and accuracy of the amounts asserted on your financial statements.

Let's look at the analysis for sufficiency.



Analysis of Evidential Matter (cont.)

Analysis for Sufficiency of Evidential Matter

Item	Requested Document	Contact and Phone Number	Date Requested	Date Needed	Date Received
	Property and Equipment Management				
59.	Access to property and equipment sub-ledgers, including detail of FYXX additions, disposals/sales, transfers in/out, and accumulated depreciation				

Auditors' substantive tests will be much more extensive in an initial audit of an entity than in a repeat engagement.

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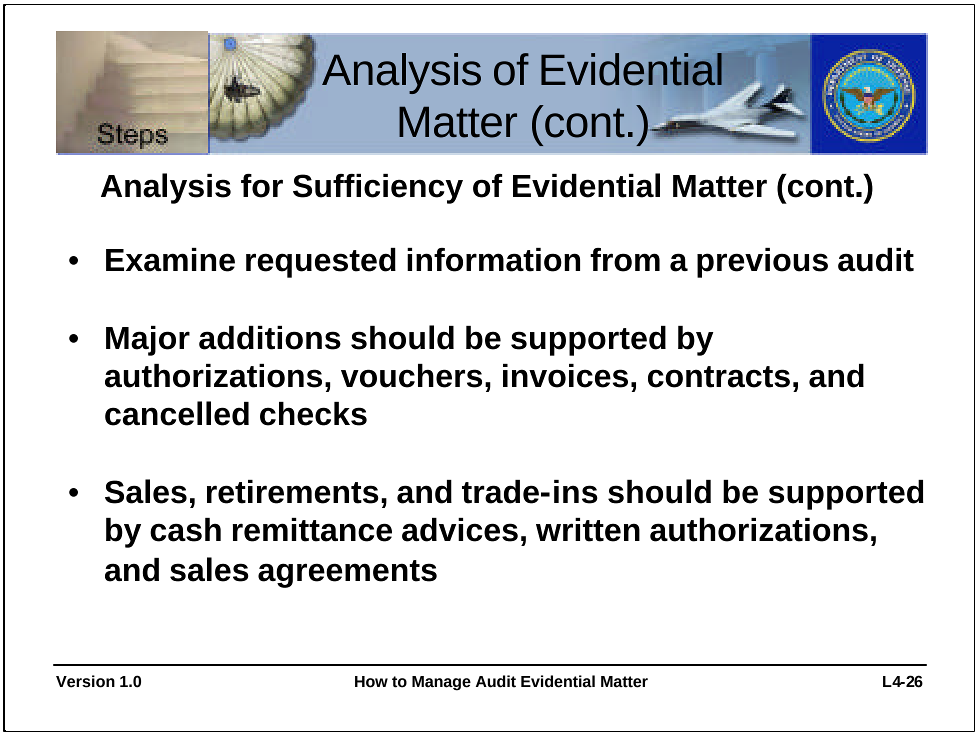
Using an item from the example PBC list, the auditors base their request on previous audits or audits of similar organizations. You can assume that the auditors will request access to property and equipment sub-ledgers, including detail of the fiscal years additions, disposals/sales, transfers in/out, and accumulated depreciation.

You must remember that the auditors' substantive tests will be much more extensive in an initial audit of an entity than in a repeat engagement. In the first audit, evidence must be obtained on the propriety of beginning balances in the accounts and the ownership of the assets that make up the balances. When a previous audit has been conducted, this evidence is supplemented by working papers generated on the previous audit.

In analyzing the sufficiency of information that must be provided for the audit, you must make a determination of what evidence the auditors already have and what may be required. Let's look at a few sources for making that determination.



Analysis of Evidential Matter (cont.)

Analysis for Sufficiency of Evidential Matter (cont.)

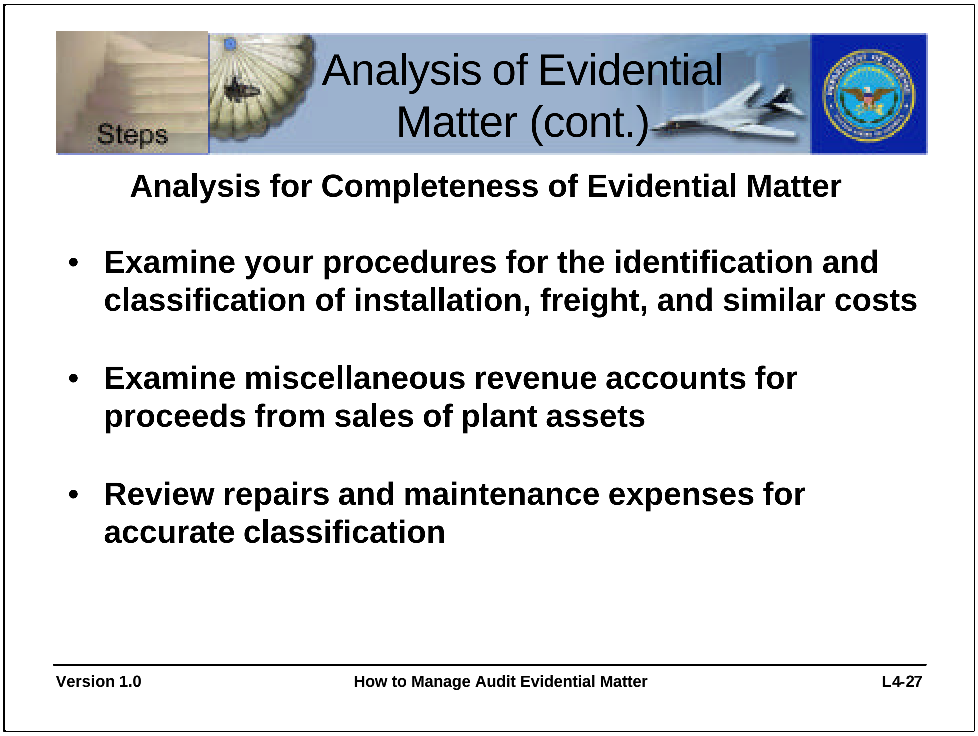
- **Examine requested information from a previous audit**
- **Major additions should be supported by authorizations, vouchers, invoices, contracts, and cancelled checks**
- **Sales, retirements, and trade-ins should be supported by cash remittance advices, written authorizations, and sales agreements**

Your first source is a listing of what was requested and provided on previous audits. If you have no audit history, you should network with a similar organization that has been audited and find out what items of evidence were requested.

All major additions should be supported by documentation in the form of authorizations, vouchers, invoices, contracts, and cancelled checks. The recorded amounts should be matched to supporting documentation. If there are numerous transactions, the matching may be done on a test basis to ensure that your procedures for matching these documents can be duplicated once specific transaction detail is requested by the auditors.

An example of matching transactions to supporting documentation is that evidence of sales, retirements, and trade-ins should be available to support the audit in the form of cash remittance advices, written authorizations, and sales agreements.

Now let’s look at analysis for completeness.



Analysis of Evidential Matter (cont.)

Analysis for Completeness of Evidential Matter

- **Examine your procedures for the identification and classification of installation, freight, and similar costs**
- **Examine miscellaneous revenue accounts for proceeds from sales of plant assets**
- **Review repairs and maintenance expenses for accurate classification**

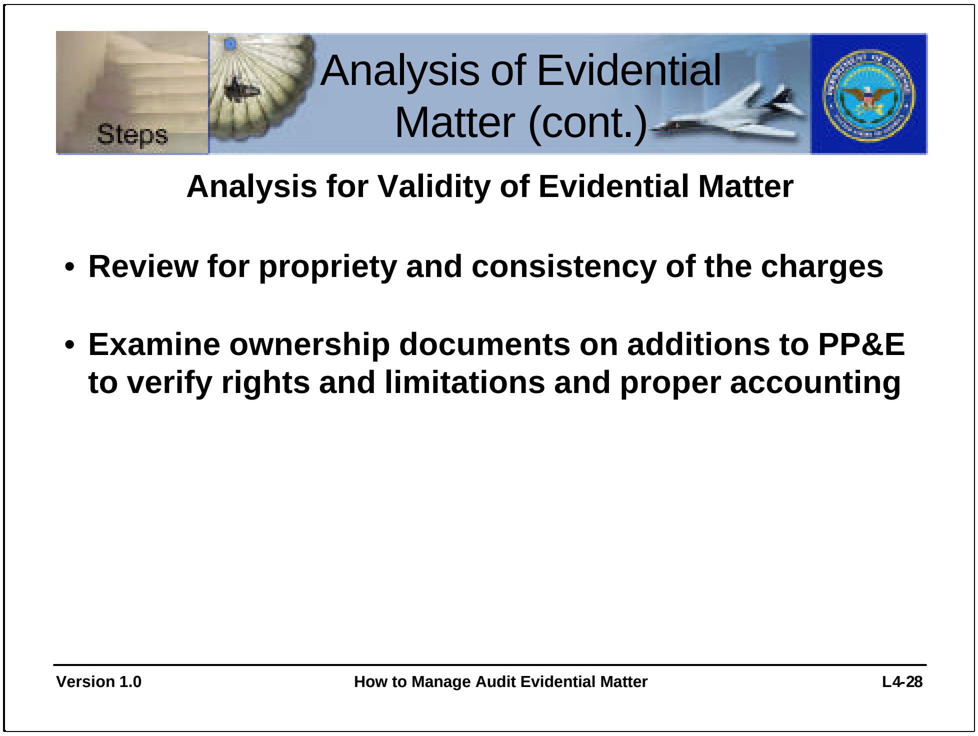
In analyzing additions to PP&E for completeness, the auditors ascertain that the appropriate accounting recognition has been given to installation, freight, and similar costs. These areas are often misclassified or identified to the wrong asset. In analyzing for completeness, you may want to examine your procedures for the identification and classification of these costs.

In analyzing disposals of PP&E, the auditors analyze miscellaneous revenue accounts for proceeds from sales of plant assets. The auditors also investigate the disposal of facilities associated with discontinued operations. The auditors may also make inquiries of management as to retirements of PP&E.

Entries to repairs and maintenance expenses are reviewed for expenses that should have been capitalized in order to ensure the completeness of the capitalized asset accounts.

The auditors may tour facilities to look for indications of additions or retirements not listed on schedules.

Let's continue with a look at analysis for validity.



Analysis of Evidential Matter (cont.)

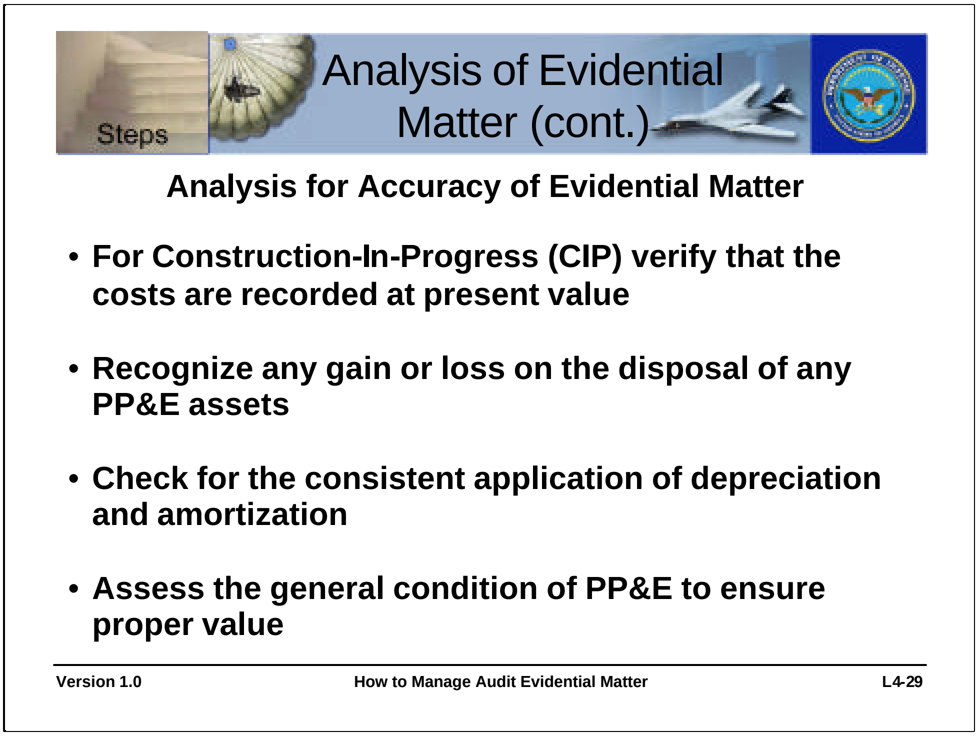
Analysis for Validity of Evidential Matter

- **Review for propriety and consistency of the charges**
- **Examine ownership documents on additions to PP&E to verify rights and limitations and proper accounting**

In reviewing entries to repairs and maintenance expense accounts, you may also review for propriety and consistency of the charges to repairs expense. Propriety involves consideration of whether your entity makes a distinction between capital and revenue expenditures. Accordingly, you should scan individual charges to identify those that are sufficiently material to be capitalized. The supporting documentation should be available on any items that are close to threshold amounts or may be questionable as to their accounting treatment.

In examining PP&E additions, check certificates of title, deeds, transfer documents, and paid invoices to validate ownership. Verification of ownership in real property can also be substantiated by a review of public records. Lease agreements convey to the lessee the right to use PP&E, usually for a specified period of time. The auditors may read the lease agreements to determine the proper accounting classification of the lease.

Let's consider analysis for accuracy.



Analysis of Evidential Matter (cont.)

Analysis for Accuracy of Evidential Matter

- **For Construction-In-Progress (CIP) verify that the costs are recorded at present value**
- **Recognize any gain or loss on the disposal of any PP&E assets**
- **Check for the consistent application of depreciation and amortization**
- **Assess the general condition of PP&E to ensure proper value**

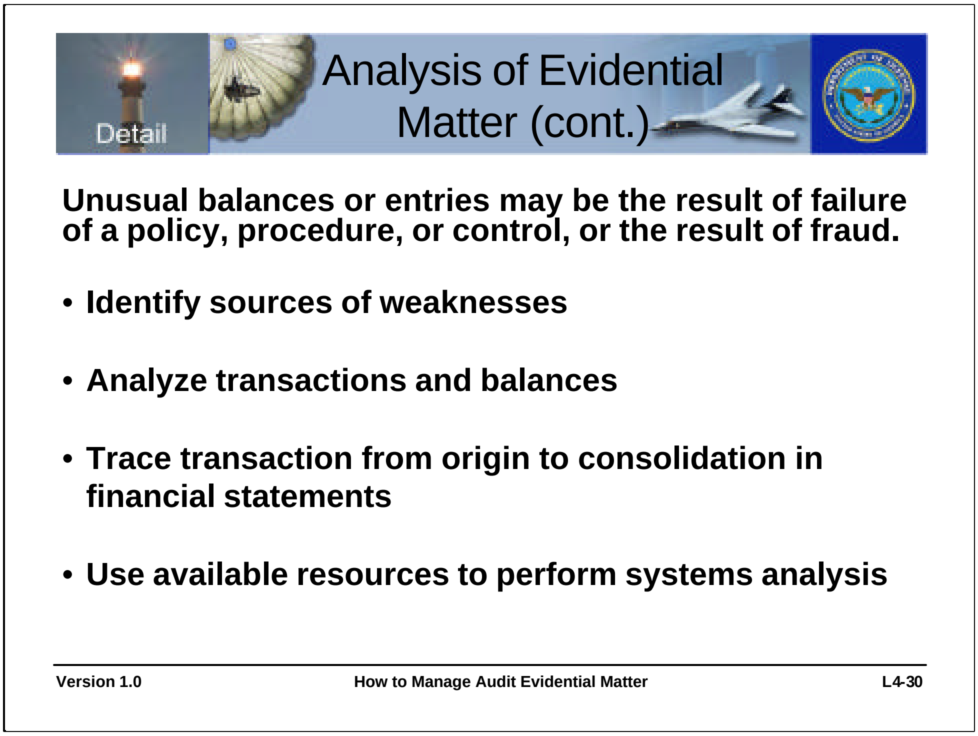
For CIP, review the contract and documentation in support of construction costs. When plant assets are acquired under a capital lease, the cost of the property and the related liability should be recorded at present value of the future minimum lease payments. This may differ from cost estimates used for budget purposes as they may show costs based on funding requirements in future years. The auditors verify these amounts by re-computation.

Asset disposal documents should be carefully examined to determine the accuracy and propriety of the accounting records, including the recognition of gain or loss, if any.

Check for the consistent application of PP&E valuation methods, including the method of depreciation or amortization.

Tours of facilities provide evidence regarding general condition of PP&E and whether they are currently being used. Unused and unserviceable equipment should be properly disposed of or repaired.

Let’s look at some potential areas of weaknesses that you may identify through your analytical processes.



Analysis of Evidential Matter (cont.)

Unusual balances or entries may be the result of failure of a policy, procedure, or control, or the result of fraud.

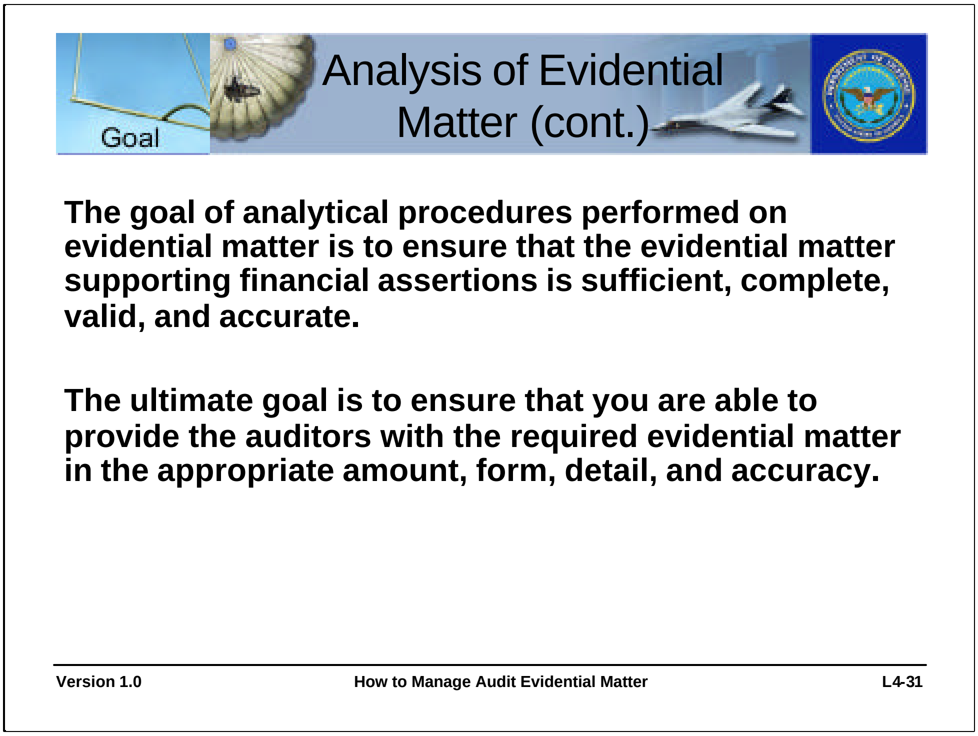
- **Identify sources of weaknesses**
- **Analyze transactions and balances**
- **Trace transaction from origin to consolidation in financial statements**
- **Use available resources to perform systems analysis**

From the discussion of analytical processes, you understand that analysis of financial information, documentation, and systems is used to identify unusual balances or entries, document trails and areas of inadequate documentation, and evaluate system controls. These are potential areas of weakness. Unusual balances or entries may be the result of failure of a policy, procedure, or control, or the result of fraud.

Instances of when complete documentation doesn't exist to be able to trace transactions from their origin to their consolidation into the financial statements must be identified. An analysis of the documentation required for transaction types assists in making this identification. Reversing the process traces a consolidated transaction to its origins. Auditors must be able to trace your transactions all the way to the originating documents. They must also be able to verify from those documents that amounts recorded on the financial statements are based on factual information, that adjustments made to that information are made using appropriate accounting practices, and that proper authorization exists at each level of the transaction.

Systems analysis may be accomplished using resources from outside of your entity. The Defense Information Systems Agency (DISA) is one source. Another is DFAS. Systems are analyzed to ensure that they are compatible with the future plans of the Department, and that they apply adequate controls for transaction authorization and separation of duties. They are also analyzed for their ability to provide meaningful financial information in a timely manner.

Now let's consider the goals of the analytical processes.



Analysis of Evidential Matter (cont.)

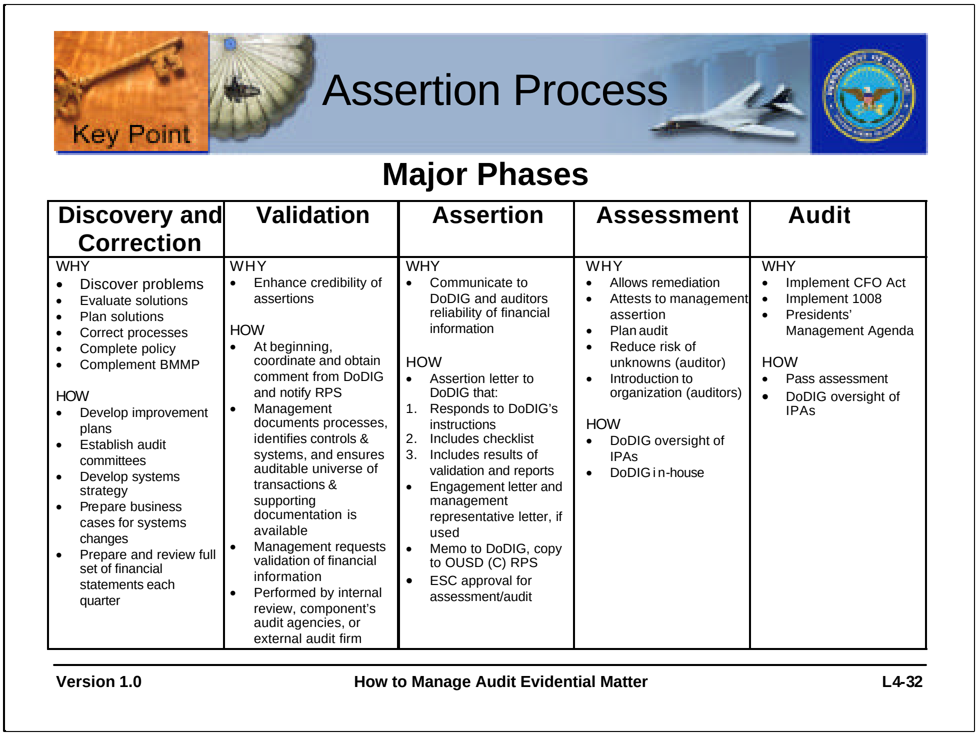
The goal of analytical procedures performed on evidential matter is to ensure that the evidential matter supporting financial assertions is sufficient, complete, valid, and accurate.

The ultimate goal is to ensure that you are able to provide the auditors with the required evidential matter in the appropriate amount, form, detail, and accuracy.

The goal of analytical procedures performed on evidential matter is to ensure that the evidential matter supporting financial assertions is sufficient, complete, valid, and accurate. The ultimate goal is to ensure that you are able to provide the auditors with the required evidential matter in the appropriate amount, form, detail, and accuracy.

By performing the analysis, you gain confidence in your ability to provide the needed information and your confidence will show in the manner in which you present it for audit. By understanding the tools that the auditors use for analyzing your evidential matter, you can anticipate the audit requirements, train your staff accordingly, and save time and money.

Now that you are familiar with some of the analytical processes and the tools that are available in performing this analysis, you must gain an understanding of the steps toward asserting your audit readiness. Let’s continue with a look at the assertion process.



Key Point

Assertion Process

Major Phases

Discovery and Correction	Validation	Assertion	Assessment	Audit
WHY • Discover problems • Evaluate solutions • Plan solutions • Correct processes • Complete policy • Complement BMMP HOW • Develop improvement plans • Establish audit committees • Develop systems strategy • Prepare business cases for systems changes • Prepare and review full set of financial statements each quarter	WHY • Enhance credibility of assertions HOW • At beginning, coordinate and obtain comment from DoDIG and notify RPS • Management documents processes, identifies controls & systems, and ensures auditable universe of transactions & supporting documentation is available • Management requests validation of financial information • Performed by internal review, component's audit agencies, or external audit firm	WHY • Communicate to DoDIG and auditors reliability of financial information HOW • Assertion letter to DoDIG that: 1. Responds to DoDIG's instructions 2. Includes checklist 3. Includes results of validation and reports • Engagement letter and management representative letter, if used • Memo to DoDIG, copy to OUSD (C) RPS • ESC approval for assessment/audit	WHY • Allows remediation • Attests to management assertion • Plan audit • Reduce risk of unknowns (auditor) • Introduction to organization (auditors) HOW • DoDIG oversight of IPAs • DoDIG in-house	WHY • Implement CFO Act • Implement 1008 • Presidents' Management Agenda HOW • Pass assessment • DoDIG oversight of IPAs

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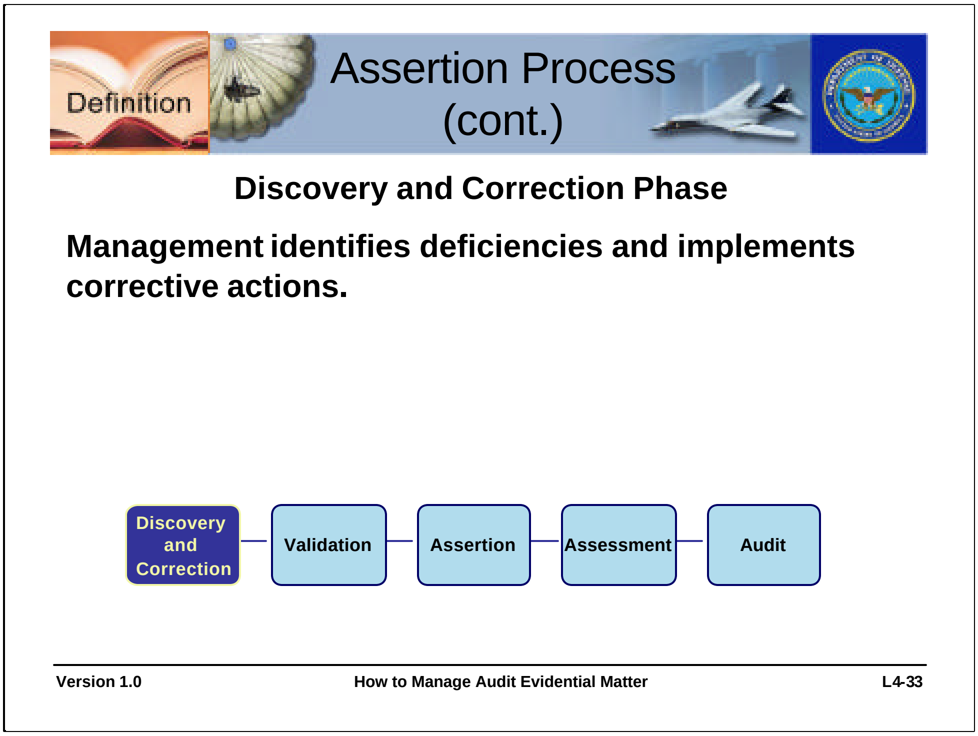
Section 1008 of the National Defense Authorization Act for Fiscal Year 2002 required that the USD(C) assess the reliability of the DoD financial statements. For those statements deemed unreliable, the USD(C) redirected resources expended on financial statements audits to efforts toward improving the entity's ability to report reliable financial information.

DoD is accomplishing the difficult task of improved financial management through several initiatives including the financial improvement initiative.

The scope of these improvements encompasses policies, processes, controls, defense business systems, personnel, organizations, performance metrics, and auditors' assessments and audits that are directly or indirectly related to DoD financial management.

The financial improvement business rules have a five-phase process designed to improve your entity's ability to control and report on your financial activities.

The first phase of this initiative is the Discovery and Correction phase. Let's begin with this phase.



Definition

Assertion Process (cont.)

Discovery and Correction Phase

Management identifies deficiencies and implements corrective actions.

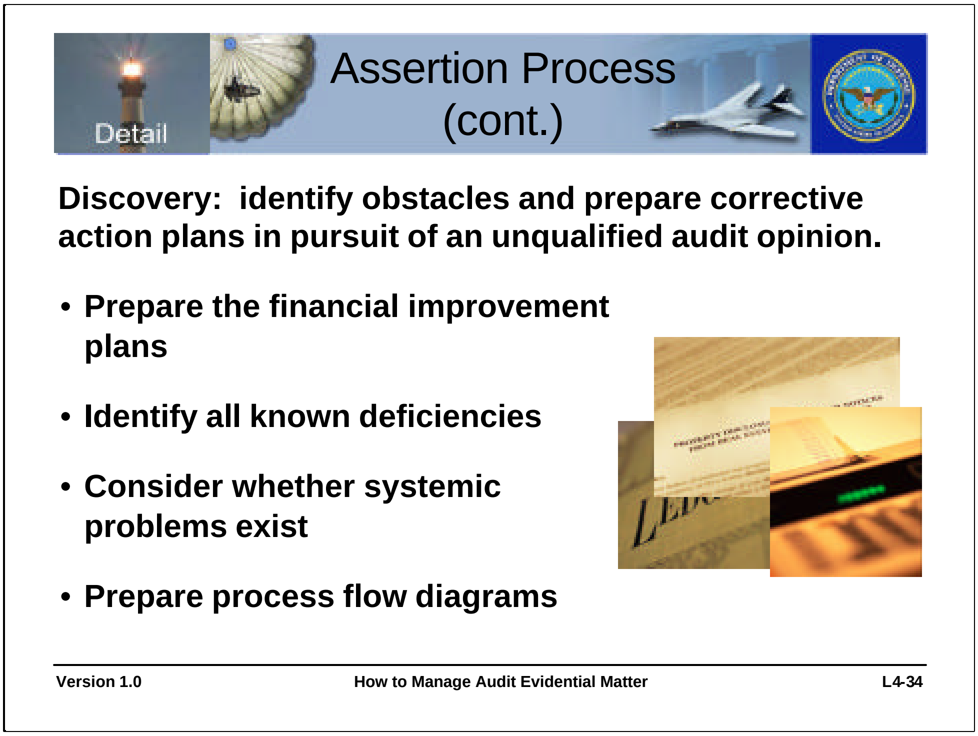
Discovery and Correction — Validation — Assertion — Assessment — Audit

The Discovery and Correction phase is intended to correct deficiencies and plan solutions to produce accurate data.

As managers, you must identify problem areas or deficiencies, then develop solutions to those problems. Problems may be identified from prior assessments or audits, analysis, tests of controls, or internal reviews of operations and procedures. They may include DoD issues and systems, issues affecting your subordinate organizations (your suballotees), or issues that are internal to your operation. Once problems are identified, you develop plans for corrective action.

These plans must include responsibilities, milestones, and required resources. They should take into account the plans of your subordinate organizations and may depend on the plans of higher organizations or operations. You must monitor progress both within and outside of your organization to ensure that milestones are reached. Resources outside of your organization may be available to you, and solutions found by other organizations may be applicable to problems within your operation. Plans for corrective action may already be initiated on deficiencies found on previous audits and assessments, and new problems may be identified during their correction.

Let’s break this phase down into it’s two components, discovery and correction.



Assertion Process (cont.)

Discovery: identify obstacles and prepare corrective action plans in pursuit of an unqualified audit opinion.

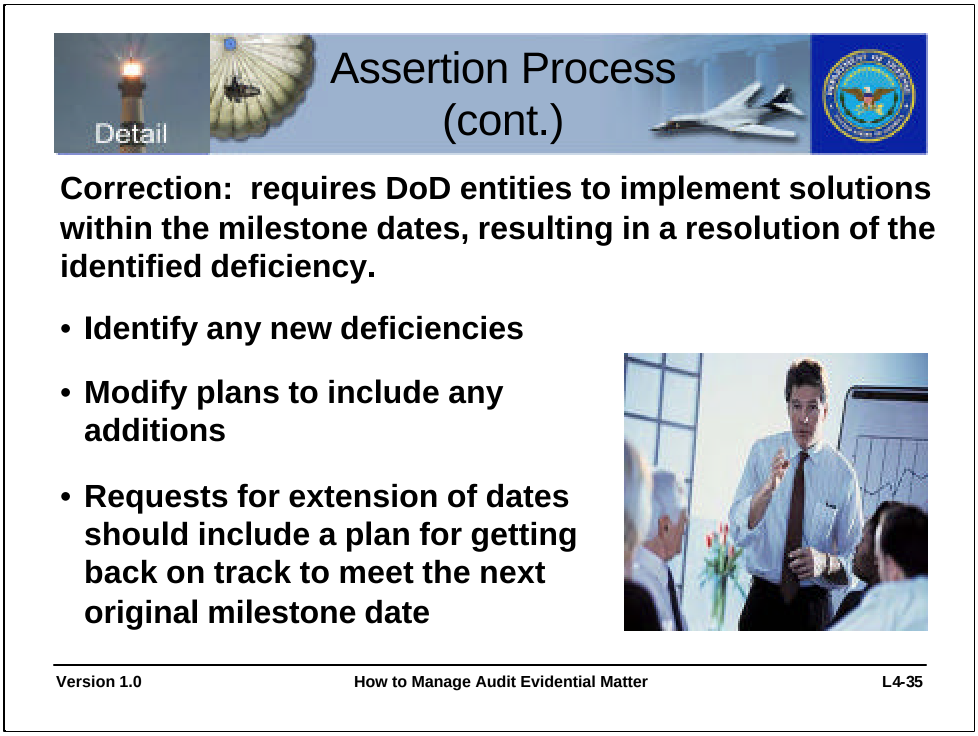
- **Prepare the financial improvement plans**
- **Identify all known deficiencies**
- **Consider whether systemic problems exist**
- **Prepare process flow diagrams**

The purpose of discovery is to identify obstacles that could prevent the entity from obtaining an unqualified audit opinion and to prepare improvement plans with solutions that have measurable outcomes for overcoming those obstacles.

Agency managers and staff should be encouraged to identify and report deficiencies, as this reflects positively on the agency’s commitment to recognizing and addressing management problems. Failing to report a known deficiency would reflect adversely on the agency. Agencies should carefully consider whether systemic problems exist that adversely affect management controls across organizational or program lines. Management should prepare process flow diagrams that include internal control and system interfaces.

In this portion of the Discovery and Correction phase, entities prepare the financial improvement plans for achieving an unqualified audit opinion of their financial statements. Entities also identify in their plans, by financial statements line item, all known deficiencies relating to the item, including accounts requiring correction and processes requiring improvement.

Now let’s consider correction.



Assertion Process (cont.)

Correction: requires DoD entities to implement solutions within the milestone dates, resulting in a resolution of the identified deficiency.

- **Identify any new deficiencies**
- **Modify plans to include any additions**
- **Requests for extension of dates should include a plan for getting back on track to meet the next original milestone date**

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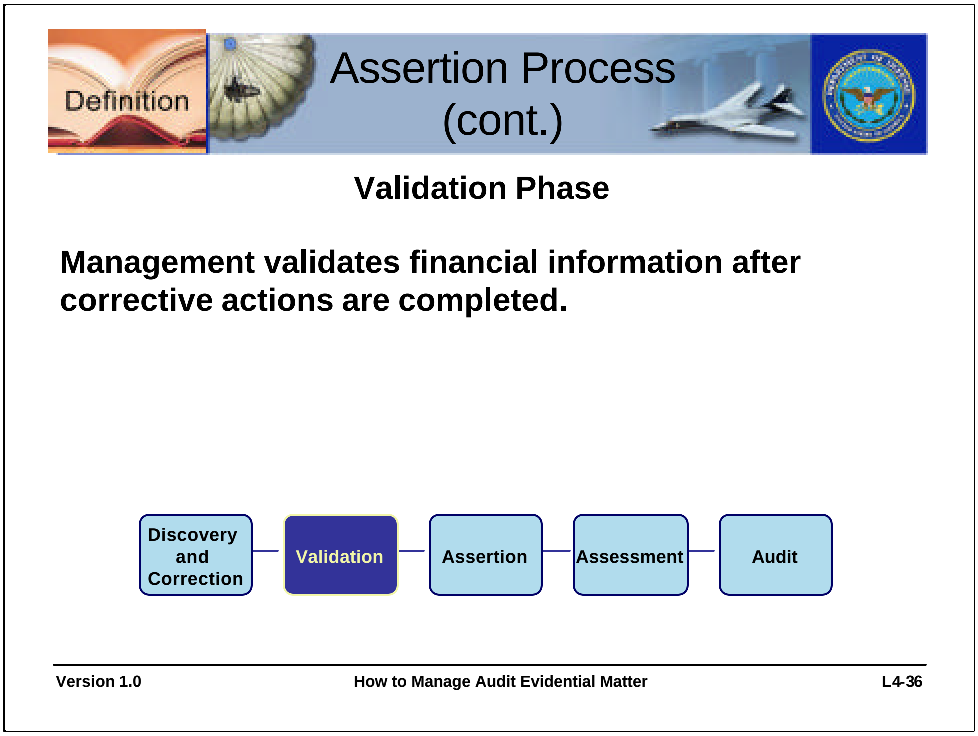
Correction requires DoD entities to implement solutions within the milestone dates, resulting in a resolution of the identified deficiency. Correction is a multi-faceted and incremental process. In other words, all corrective action steps are not expected to be completed on the same date. Management personnel and audit committees at each activity closely monitor progress to ensure that actions taken achieve the intended result in the time allotted.

As corrections are ongoing, it is anticipated that new deficiencies may be identified. As this occurs, activities coordinate with their OUSD(C) POC to modify plans to include any such additions. Requests for extension of dates should include actions taken to date, reason for date slippage, new proposed completion date, and a plan for getting back on track to meet the next original milestone date.

Let’s move on to the Validation phase.



Definition

Assertion Process (cont.)

Validation Phase

Management validates financial information after corrective actions are completed.

Discovery and Correction — Validation — Assertion — Assessment — Audit

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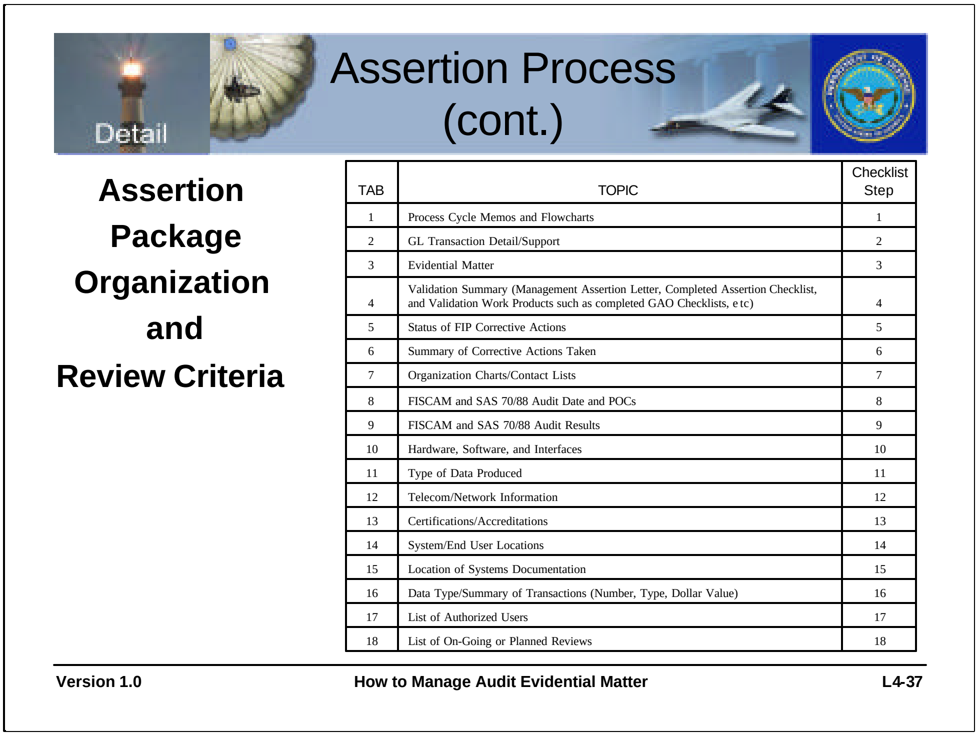
The purpose of the Validation Phase is to validate the effectiveness of the corrective actions. Validation determines whether sufficient controls and transaction information are available to support management's assertion that the line or statement is ready for audit, and ensures that supporting documentation is available for audit.

A validation is a limited scope evaluation or review to determine whether previously identified deficiencies in an entity's financial statements or line items have been satisfactorily remedied. This review is the responsibility of management and may be performed by management, internal auditors, or a contractor under the supervision of management. The scope of specific procedures required for each validation are also the responsibility of management and are determined in the context of the materiality of each issue or action taken.

At the beginning of the Validation phase, entities notify the DoD OIG by memorandum, with a copy furnished to the entity's OUSD(C) POC, of the entity's intent to validate a line or statement and the corrective actions taken to resolve deficiencies. It is important to tell the DoD OIG what you plan to do. The DoD OIG must be aware of the validation technique being performed by the entity prior to the initiation of the validation process to facilitate the assessment process after the entity submits its assertion package. Although the DoD OIG has no specific role in the validation, the DoD OIG may, in an advisory capacity, comment on any obvious flaws or items of concern related to the validation methodology.

The notification includes the intended method for validating that the corrective action corrected the known deficiency, and that the line or statement is ready for audit. Once required notification is sent, and validation methods are planned, the validation process begins.

Let's discuss the actions required in this phase.



Assertion Process (cont.)

Assertion Package Organization and Review Criteria

TAB	TOPIC	Checklist Step
1	Process Cycle Memos and Flowcharts	1
2	GL Transaction Detail/Support	2
3	Evidential Matter	3
4	Validation Summary (Management Assertion Letter, Completed Assertion Checklist, and Validation Work Products such as completed GAO Checklists, etc)	4
5	Status of FIP Corrective Actions	5
6	Summary of Corrective Actions Taken	6
7	Organization Charts/Contact Lists	7
8	FISCAM and SAS 70/88 Audit Date and POCs	8
9	FISCAM and SAS 70/88 Audit Results	9
10	Hardware, Software, and Interfaces	10
11	Type of Data Produced	11
12	Telecom/Network Information	12
13	Certifications/Accreditations	13
14	System/End User Locations	14
15	Location of Systems Documentation	15
16	Data Type/Summary of Transactions (Number, Type, Dollar Value)	16
17	List of Authorized Users	17
18	List of On-Going or Planned Reviews	18

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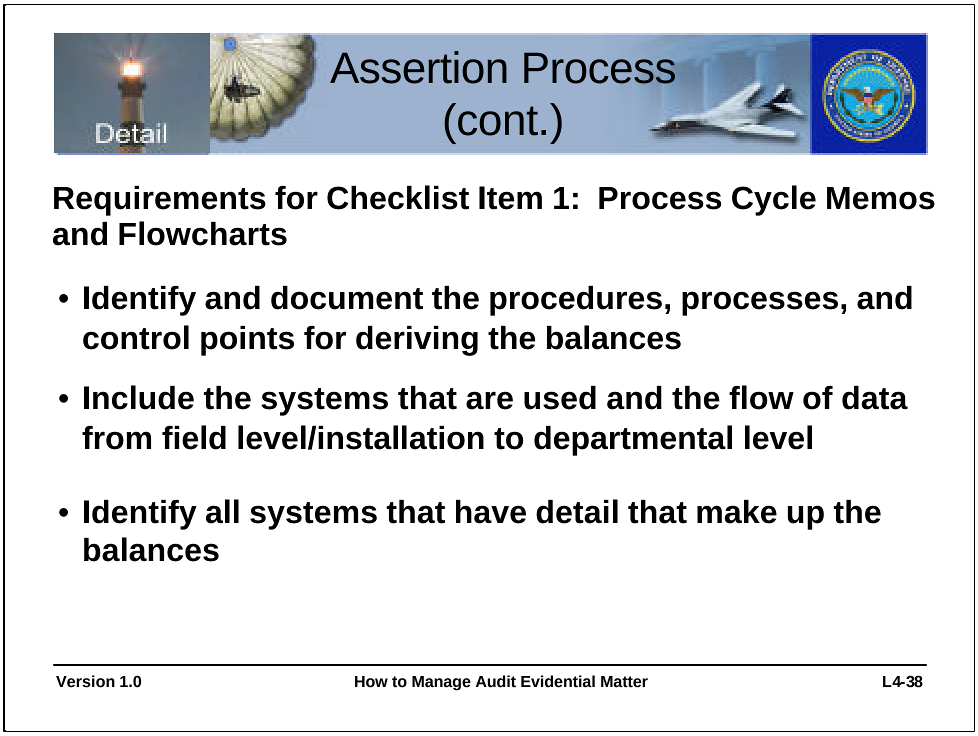
During the Validation Phase, the entity performs a validation of the resolution of the identified deficiencies. These validations are performed at the request and with the oversight of management. Audit committees within the entity should be actively engaged in overseeing the progress of the validation process.

At this time, management completes a checklist that is required for the assertion package. The checklist includes such steps as documenting processes, identifying controls and systems, and ensuring that supporting documentation is available. This checklist and accompanying assertion information is used later during the Assessment and Audit phases, and may be viewed in Appendix B, Assertion Package Organization and Review Criteria.

Notice that the checklist begins with the topic Process Cycle Memos and Flowcharts. You may have completed this step during the Discovery and Correction phase. To use the checklist, you must read the accompanying instructions that provide a full description of what is required to fulfill the checklist item. Let's examine the first item to demonstrate the use of this validation tool.



Assertion Process (cont.)

Requirements for Checklist Item 1: Process Cycle Memos and Flowcharts

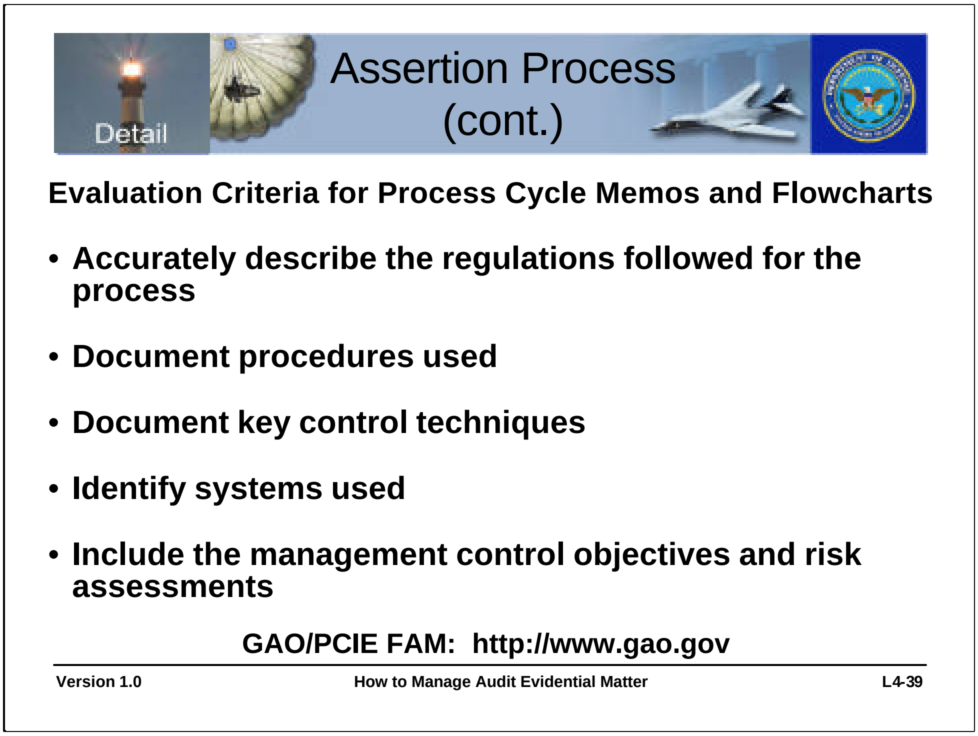
- **Identify and document the procedures, processes, and control points for deriving the balances**
- **Include the systems that are used and the flow of data from field level/installation to departmental level**
- **Identify all systems that have detail that make up the balances**

In Processing Cycle Memos and Flowcharts, the user needs to verify that procedures, processes, and control points for deriving the balance or balances being asserted have been identified and documented. The user needs to include the systems that are used and the flow of data from field level or installation to departmental level.

This can be done in a cycle memorandum or flowchart. Having this information prepared in advance will be a great tool for you to refer to during the assessment and audit. This information will also be used by the auditors as part of the audit, so you will already have the information prepared. Be sure to identify all systems that have detail that make up the balances being asserted as ready for audit.

Earlier we covered the need to identify and document the procedures, processes, and controls within your entity. This process began in the Discovery and Correction phase while you were working on the identification of problems and planning corrective actions. It continues and is completed in the Validation phase.

The instructions also include the criteria used to evaluate whether or not the required action was satisfactorily completed. Let’s look at these criteria.



Assertion Process (cont.)

Evaluation Criteria for Process Cycle Memos and Flowcharts

- **Accurately describe the regulations followed for the process**
- **Document procedures used**
- **Document key control techniques**
- **Identify systems used**
- **Include the management control objectives and risk assessments**

GAO/PCIE FAM: http://www.gao.gov

The evaluation criteria for processing cycle memos and flowcharts state that a flowchart is required for each major process and a cycle/process memorandum should be provided to:

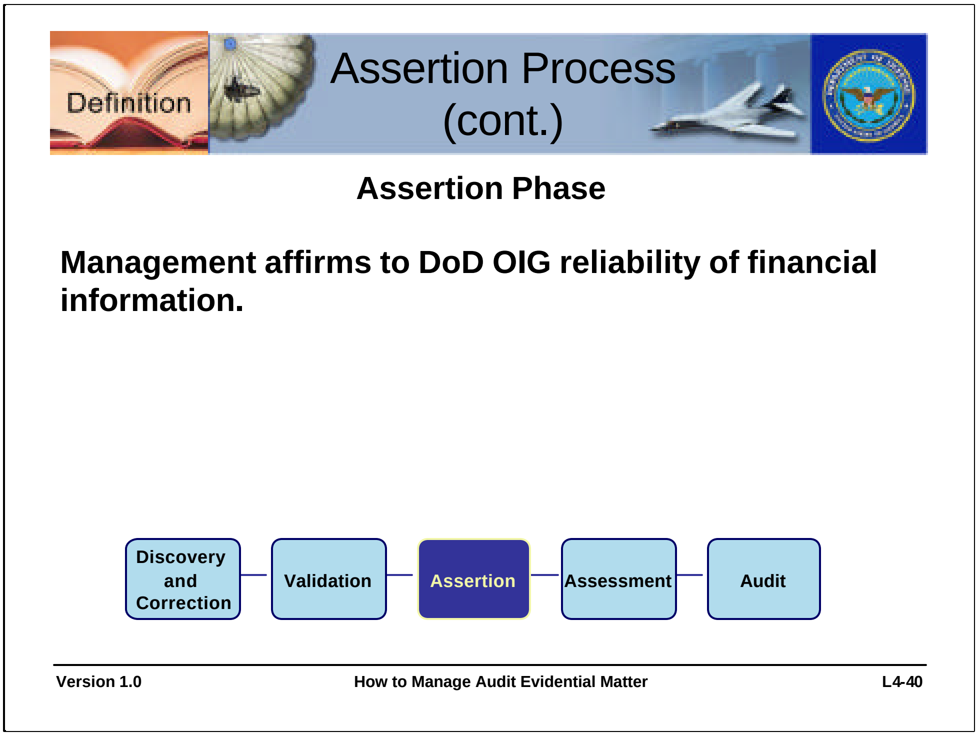
- accurately describe the regulations followed for the process
- document procedures utilized
- document key control techniques
- identify systems used
- include the management control objectives and risk assessments.

Control techniques/activities are those activities that work to ensure that resources are used consistent with laws, regulations, and policies; that they are safeguarded against waste, loss, and misuse; and that reliable data is obtained, maintained, and disclosed in reports. Examples include passwords, separation of duties, physical security, and adequate supervision among many others.

You should review the flowcharts, cycle/process memorandum, and supporting documents for reasonableness and completeness for each process listed.

The GAO/PCIE FAM Section 390.04, Cycle Memorandum and Flowchart, describes a cycle memorandum.

Now let’s look at the Assertion phase.



Definition

Assertion Process (cont.)

Assertion Phase

Management affirms to DoD OIG reliability of financial information.

Discovery and Correction — Validation — **Assertion** — Assessment — Audit

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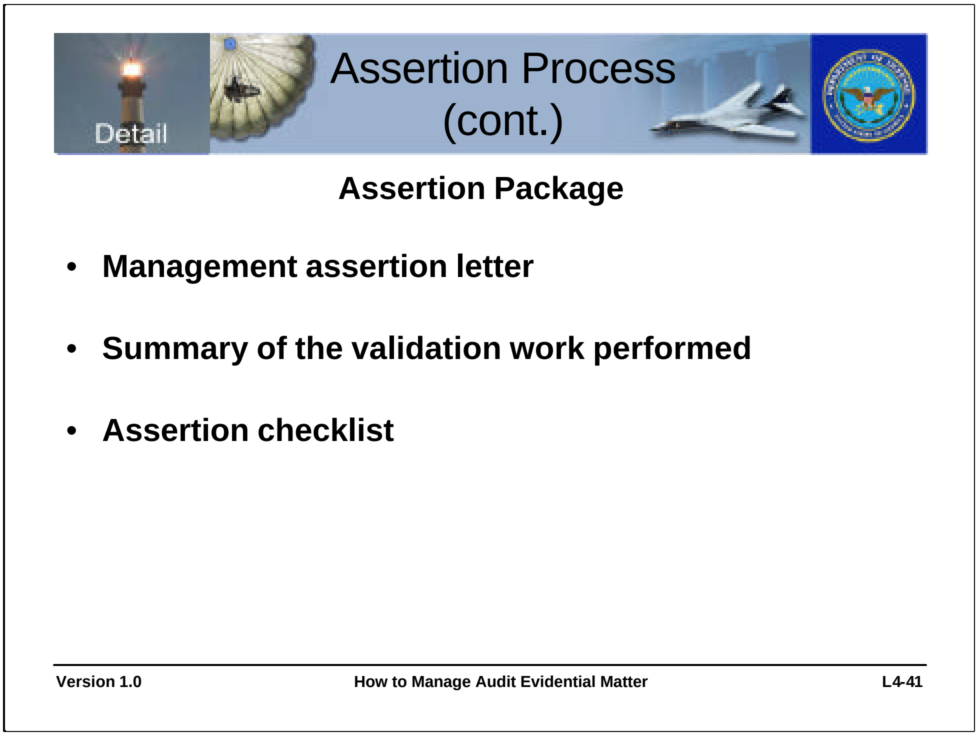
The purpose of the Assertion phase is to notify the DoD OIG that validation of corrected deficiencies has been completed and that a financial statement or line item is ready for audit. During the Assertion phase, management prepares an assertion memorandum stating audit readiness and a package of accompanying documentation to support the position of audit readiness.

Let’s learn more about this phase.



Assertion Process (cont.)

Assertion Package

- **Management assertion letter**
- **Summary of the validation work performed**
- **Assertion checklist**

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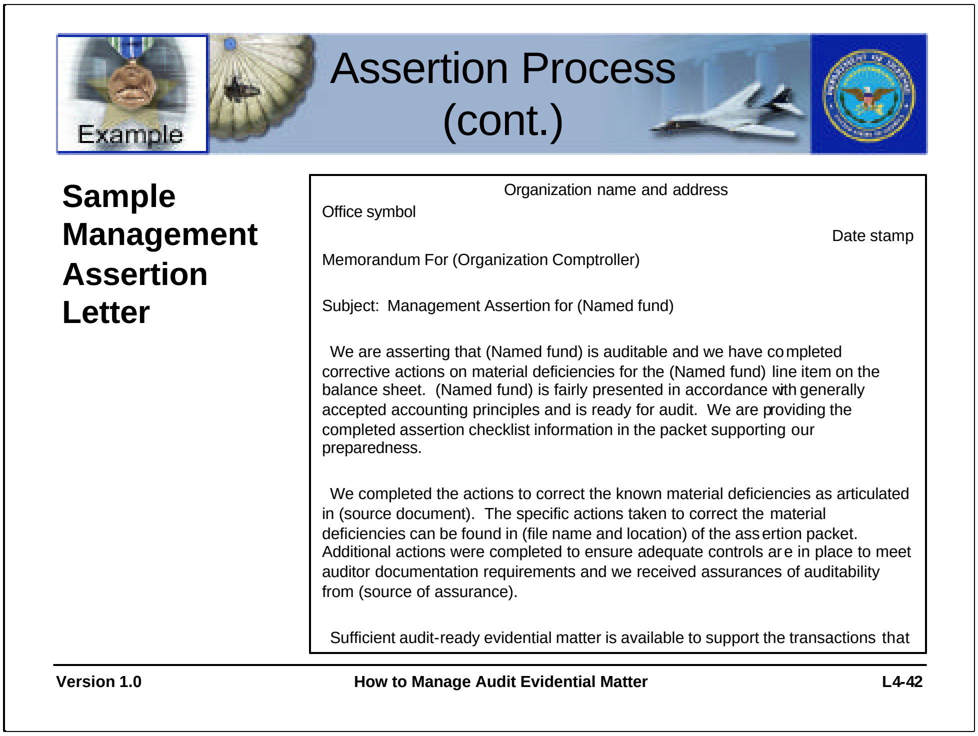
The assertion package is submitted to DoD OIG with a copy furnished to the OUSD(C) POC, who forwards it to the Review and Prioritization Sub-committee (RPS).

The assertion package contains:

- the management assertion letter
- a summary of the validation work performed that contains an explanation of actions taken by management to resolve deficiencies, and reports resulting from validation
- the assertion checklist that was completed during the Validation phase.

If the entity prepares an engagement letter or a management representation letter for the DoD OIG, subsequent representation letters should reflect management's assertions in them.

Let's look at each of these documents.



Assertion Process (cont.)

Sample Management Assertion Letter

Organization name and address

Office symbol

Date stamp

Memorandum For (Organization Comptroller)

Subject: Management Assertion for (Named fund)

We are asserting that (Named fund) is auditable and we have completed corrective actions on material deficiencies for the (Named fund) line item on the balance sheet. (Named fund) is fairly presented in accordance with generally accepted accounting principles and is ready for audit. We are providing the completed assertion checklist information in the packet supporting our preparedness.

We completed the actions to correct the known material deficiencies as articulated in (source document). The specific actions taken to correct the material deficiencies can be found in (file name and location) of the assertion packet. Additional actions were completed to ensure adequate controls are in place to meet auditor documentation requirements and we received assurances of auditability from (source of assurance).

Sufficient audit-ready evidential matter is available to support the transactions that

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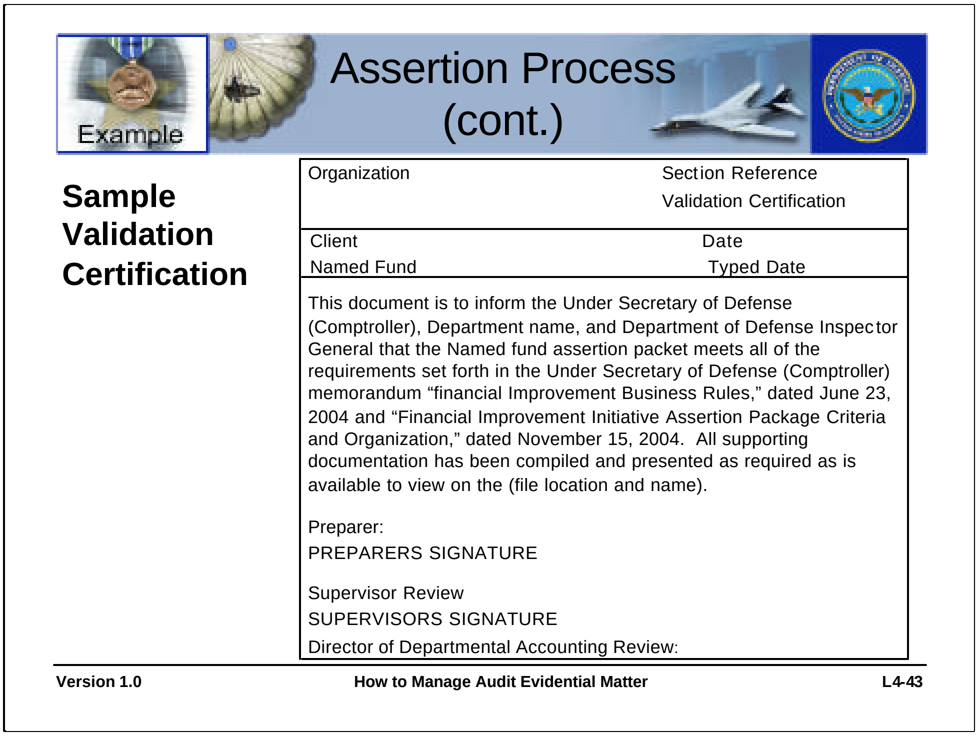
In this sample management assertion letter, the organization is asserting that the named fund is auditable and that material deficiencies concerning a particular line item have been corrected. The assertion also states that the line item is fairly presented in accordance with generally accepted accounting principles and is ready for audit. An example could be the General Property, Plant, and Equipment (PP&E) line item from the General Fund financial statements.

It then states the items included in the assertion packet that support this assertion.

The assertion letter contains the required assurance that sufficient audit-ready evidential matter is available to support the transactions that constitute the named fund, and the assurance that sufficient knowledgeable staff is available to support audit requests during audit fieldwork.

Next is to summarize the validation information. This includes the Validation Certificate and the Validation Summary.

Let’s take a look at those documents.



Assertion Process (cont.)

Sample Validation Certification

Organization	Section Reference Validation Certification
Client Named Fund	Date Typed Date

This document is to inform the Under Secretary of Defense (Comptroller), Department name, and Department of Defense Inspector General that the Named fund assertion packet meets all of the requirements set forth in the Under Secretary of Defense (Comptroller) memorandum “financial Improvement Business Rules,” dated June 23, 2004 and “Financial Improvement Initiative Assertion Package Criteria and Organization,” dated November 15, 2004. All supporting documentation has been compiled and presented as required as is available to view on the (file location and name).

Preparer:
PREPARERS SIGNATURE

Supervisor Review
SUPERVISORS SIGNATURE
Director of Departmental Accounting Review:

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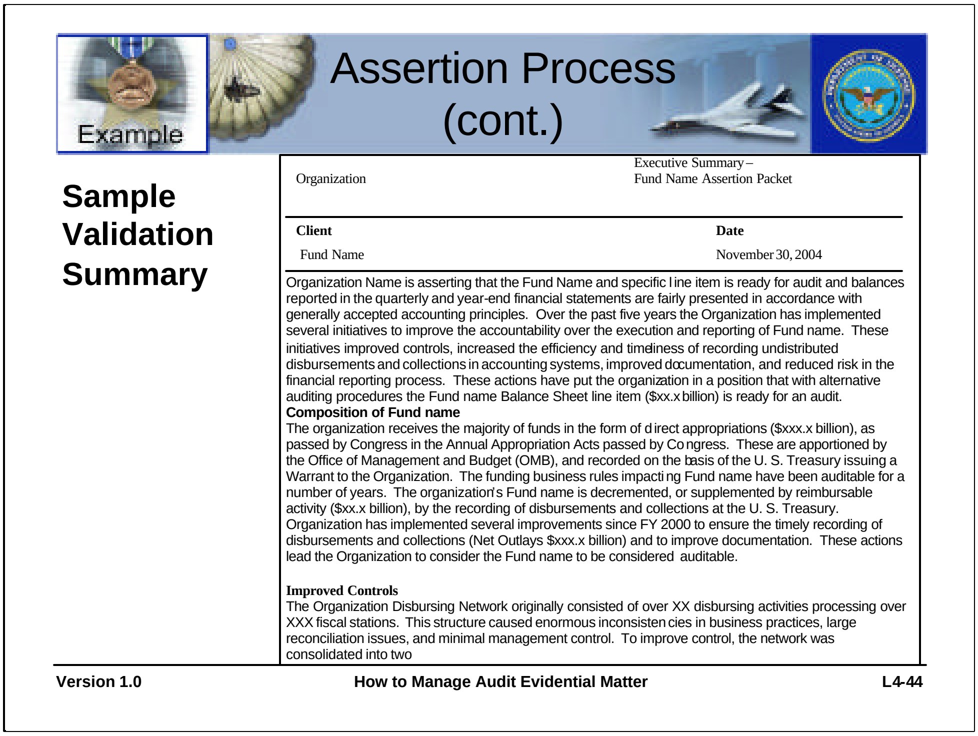
In the example of the Validation Certification, the preparer, reviewers, and other members of management annotate with their signatures that the named fund assertion packet meets all of the requirements set forth in the USD(C) memorandum concerning the financial improvement business rules and the memorandum subject Assertion Package Criteria and Organization. They assert that all supporting documentation has been completed and presented as required and is available to view at a specific file location.

Now let’s look at the Validation Summary.



Assertion Process (cont.)

Sample Validation Summary

Organization

Executive Summary –
Fund Name Assertion Packet

Client	**Date**
Fund Name	November 30, 2004

Organization Name is asserting that the Fund Name and specific line item is ready for audit and balances reported in the quarterly and year-end financial statements are fairly presented in accordance with generally accepted accounting principles. Over the past five years the Organization has implemented several initiatives to improve the accountability over the execution and reporting of Fund name. These initiatives improved controls, increased the efficiency and timeliness of recording undistributed disbursements and collections in accounting systems, improved documentation, and reduced risk in the financial reporting process. These actions have put the organization in a position that with alternative auditing procedures the Fund name Balance Sheet line item ($xx.x billion) is ready for an audit.

Composition of Fund name

The organization receives the majority of funds in the form of direct appropriations ($xxx.x billion), as passed by Congress in the Annual Appropriation Acts passed by Congress. These are apportioned by the Office of Management and Budget (OMB), and recorded on the basis of the U. S. Treasury issuing a Warrant to the Organization. The funding business rules impacting Fund name have been auditable for a number of years. The organization's Fund name is decremented, or supplemented by reimbursable activity ($xx.x billion), by the recording of disbursements and collections at the U. S. Treasury. Organization has implemented several improvements since FY 2000 to ensure the timely recording of disbursements and collections (Net Outlays $xxx.x billion) and to improve documentation. These actions lead the Organization to consider the Fund name to be considered auditable.

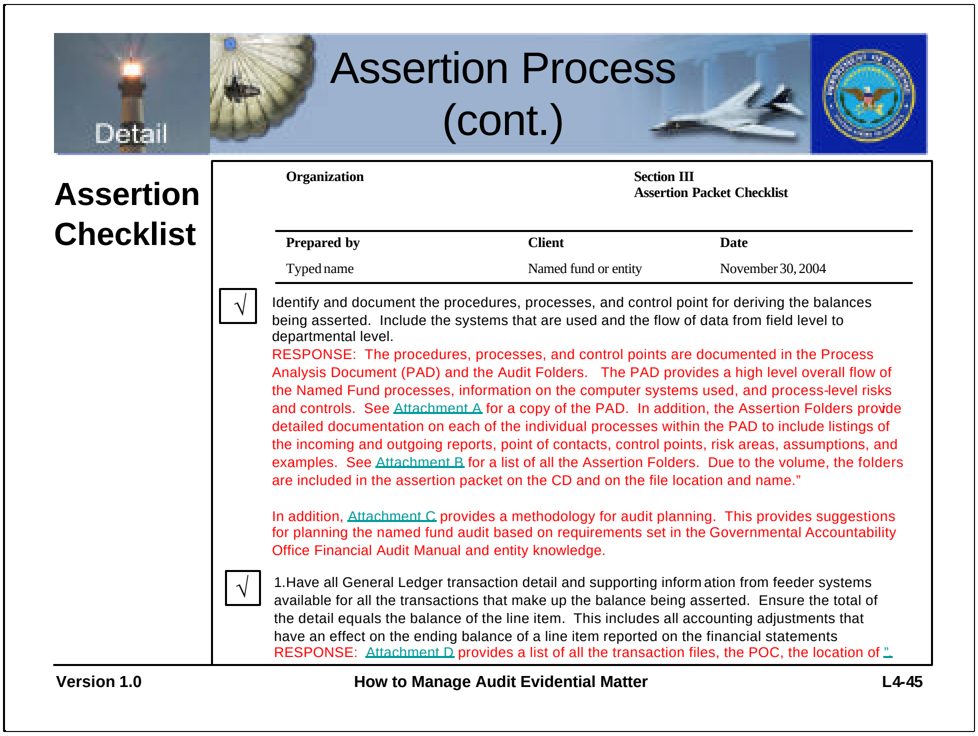
Improved Controls

The Organization Disbursing Network originally consisted of over XX disbursing activities processing over XXX fiscal stations. This structure caused enormous inconsistencies in business practices, large reconciliation issues, and minimal management control. To improve control, the network was consolidated into two

The Validation Summary outlines the corrective actions taken to improve accountability, controls, efficiency, timeliness, and documentation for the fund or balance being reported. It then states that the item is ready for an audit.

It may provide an overview of the fund prior to listing specific actions performed by the entity to prepare the fund or balance for audit. This is an area where accomplishments of the entity are highlighted and good report writing is essential. In this summary, if the subject of the audit is the General PP&E line, you may want to highlight any improvements you have made in identifying property to a particular entity, or an improved property accountability system.

Let's talk about the completed assertion checklist.



Assertion Process (cont.)

Assertion Checklist

Organization

Section III
Assertion Packet Checklist

Prepared by	**Client**	**Date**
Typed name	Named fund or entity	November 30, 2004

☑ Identify and document the procedures, processes, and control point for deriving the balances being asserted. Include the systems that are used and the flow of data from field level to departmental level.

RESPONSE: The procedures, processes, and control points are documented in the Process Analysis Document (PAD) and the Audit Folders. The PAD provides a high level overall flow of the Named Fund processes, information on the computer systems used, and process-level risks and controls. See Attachment A for a copy of the PAD. In addition, the Assertion Folders provide detailed documentation on each of the individual processes within the PAD to include listings of the incoming and outgoing reports, point of contacts, control points, risk areas, assumptions, and examples. See Attachment B for a list of all the Assertion Folders. Due to the volume, the folders are included in the assertion packet on the CD and on the file location and name."

In addition, Attachment C provides a methodology for audit planning. This provides suggestions for planning the named fund audit based on requirements set in the Governmental Accountability Office Financial Audit Manual and entity knowledge.

☑ 1.Have all General Ledger transaction detail and supporting information from feeder systems available for all the transactions that make up the balance being asserted. Ensure the total of the detail equals the balance of the line item. This includes all accounting adjustments that have an effect on the ending balance of a line item reported on the financial statements

RESPONSE: Attachment D provides a list of all the transaction files, the POC, the location of "

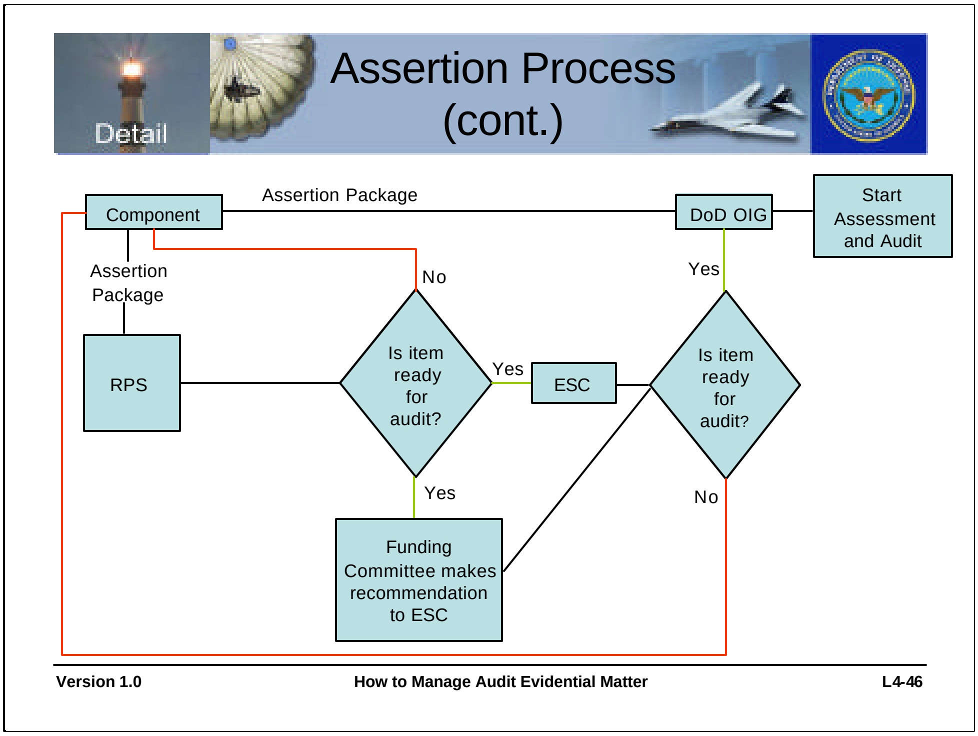
The completed assertion checklist provides a description of each topic and the entity's response to the requirements for its validation.

Process Cycle Memos and Flowcharts, Tab 1, of the Assertion Package requires that the entity identify and document the procedures, processes, and control points for deriving the balances being asserted. The corresponding response states the specific document and location where the procedures, processes, and controls are documented.

The assertion process should include the specific systems relationship between the line being asserted and all financial management systems and associated feeder systems.

For new systems that may not have previously identified problems, there is a requirement to include the CFO Act fourteen-point checklist for new systems or for each system in the assertion.

Now let's discuss the distribution of and action taken on these documents.



Detail

Assertion Process (cont.)

Component

Assertion Package

DoD OIG

Start Assessment and Audit

Assertion Package

RPS

No

Is item ready for audit?

Yes

ESC

Yes

Is item ready for audit?

Yes

Funding Committee makes recommendation to ESC

No

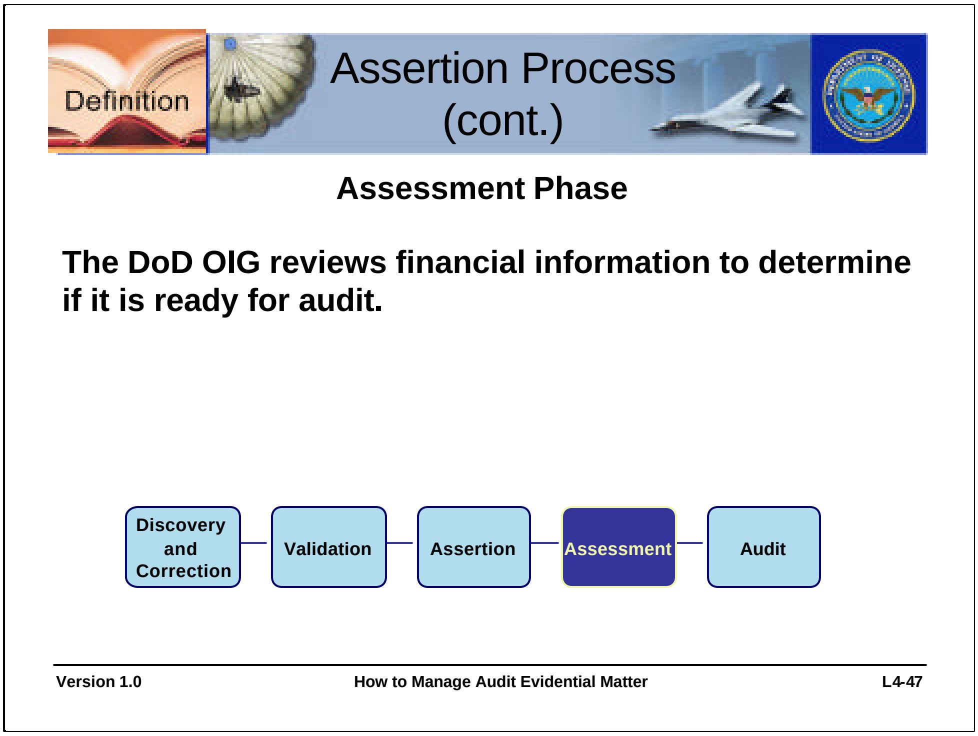
The Component simultaneously submits the assertion package to the RPS and the DoD OIG. The DoD OIG is a non-voting member of the RPS and the Executive Steering Committee (ESC). It provides valuable input into the review of the assertion packages to include assessment and audit cost estimates.

If the RPS determines that the assertion package is audit-ready, it is simultaneously submitted to the Funding Committee and the ESC with the RPS's prioritized recommendations concerning assessment and audit schedules.

The ESC, with the Funding Committees' recommendation, reviews the assertion package for audit readiness. If audit-ready, the package is forwarded to the DoD OIG for audit. Once the DoD OIG receives the approved package from the ESC, it may begin the assessment and audit.

If the RPS or ESC makes a determination that the assertion package is not audit-ready, it is returned to the submitting Component.

Let's take a quick look at the Assessment and Audit phases.



Definition

Assertion Process (cont.)

Assessment Phase

The DoD OIG reviews financial information to determine if it is ready for audit.

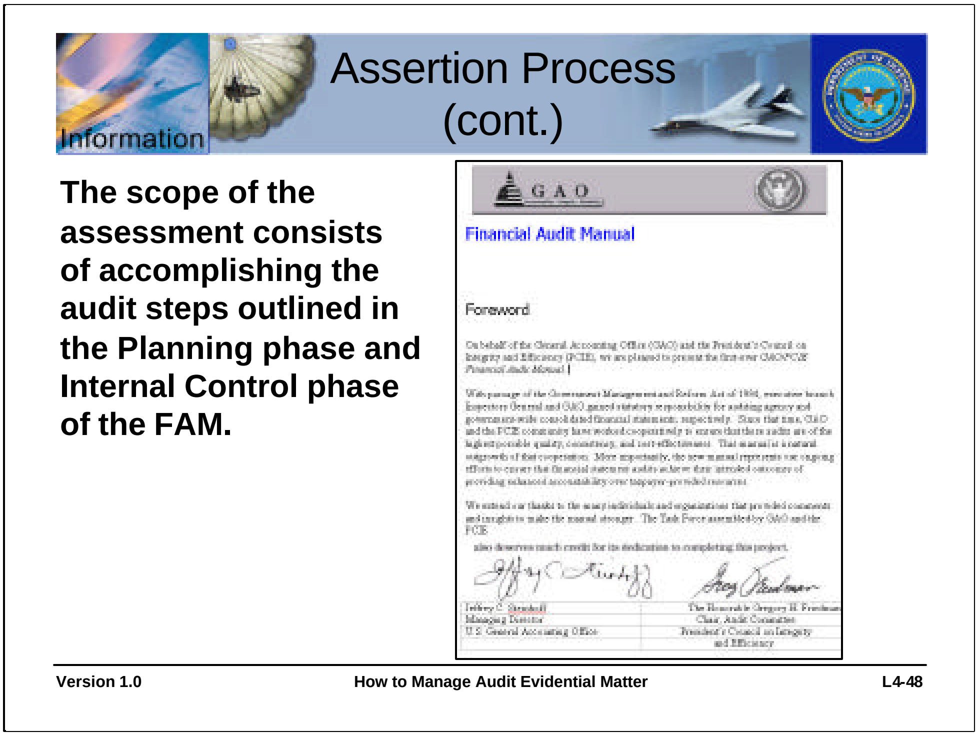
Discovery and Correction — Validation — Assertion — **Assessment** — Audit

The purpose of the Assessment phase is to determine the reliability of the line or statement that the entity asserted as being ready for audit.

This assessment is substantially less than an audit, but should be sufficient enough to verify that the corrective actions implemented during the Discovery and Correction phase of the financial improvement initiative were successful.

Assessment is generally performed first if a statement has never been audited. Assessment could also occur when the DoD OIG believes circumstances may exist that would cause the entity to obtain an opinion other than unqualified. An example of such a situation is a system of internal control allowing for the disbursement of funds without proper certification. In this case, the DoD OIG would determine that an assessment is necessary to ensure reliability as required per Section 1008. During the Assessment phase, an entity may perform a remedy in the event a deficiency is identified that would prevent an unqualified opinion.

Let’s continue with this phase.



Assertion Process (cont.)

The scope of the assessment consists of accomplishing the audit steps outlined in the Planning phase and Internal Control phase of the FAM.

GAO

Financial Audit Manual

Foreword

On behalf of the General Accounting Office (GAO) and the President's Council on Integrity and Efficiency (PCIE), we are pleased to present the first-ever GAO/PCIE *Financial Audit Manual.*

With passage of the Government Management and Reform Act of 1994, executive branch Inspectors General and GAO gained statutory responsibility for auditing agency and government-wide consolidated financial statements, respectively. Since that time, GAO and the PCIE community have worked cooperatively to ensure that these audits are of the highest possible quality, consistency, and cost-effectiveness. This manual is a natural outgrowth of that cooperation. More importantly, the new manual represents our ongoing efforts to ensure that financial statement audits achieve their intended outcomes of providing enhanced accountability over taxpayer-provided resources.

We extend our thanks to the many individuals and organizations that provided comments and insights to make the manual stronger. The Task Force assembled by GAO and the PCIE

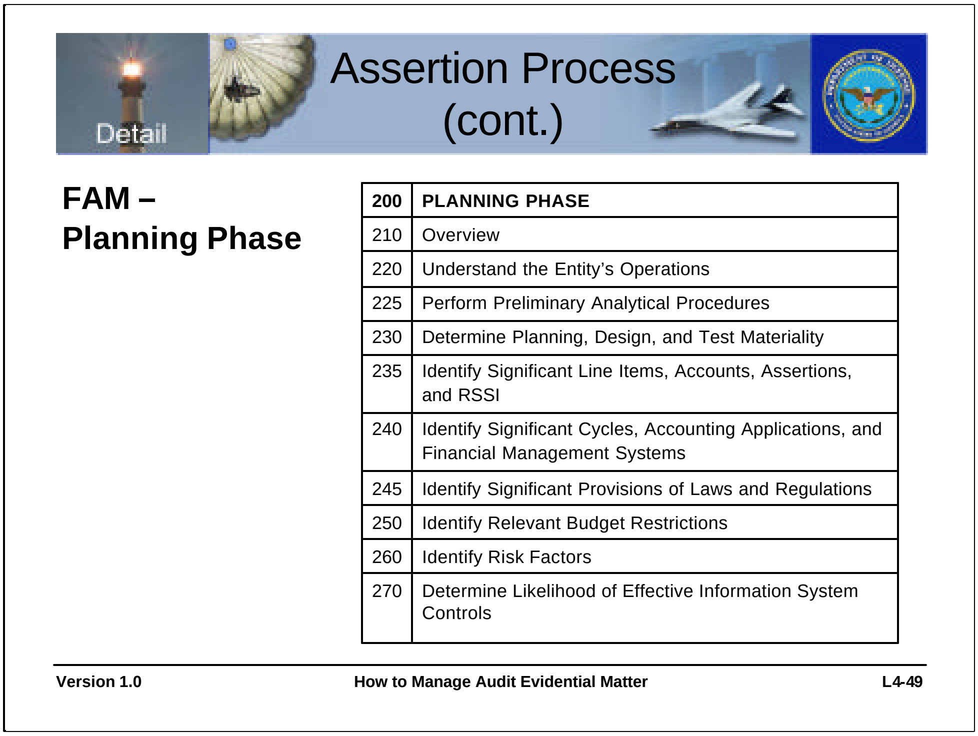
also deserves much credit for its dedication to completing this project.

Jeffrey C. Steinhoff	The Honorable Gregory H. Friedman
Managing Director	Chair, Audit Committee
U.S. General Accounting Office	President's Council on Integrity and Efficiency

The assessment is performed by the DoD OIG, or by an independent public accountant contracted to perform work for the DoD OIG, after the ESC has approved the assessment. The scope of the assessment is determined in accordance with the GAO/PCIE FAM and consists of accomplishing the audit steps outlined in the Planning phase and Internal Control phase of the audit manual. The assessment process determines whether the entity can likely achieve an unqualified audit opinion. If it is determined that circumstances or problems exist that preclude an unqualified opinion, a report is written to management that describes what has prevented the auditors from obtaining sufficient, reliable, and competent information. The report recommends to management what needs to be accomplished to remedy the problems.

The Assessment phase is used as part of the DoD OIG's audit strategy to reduce risks of the unknown and introduce new auditors to the entity's processes. Progress is reviewed and monitored by management and the entity's audit committee through regularly scheduled interim progress reports. Management informs its OUSD(C) POC of any new deficiencies identified. There is continued communication, both written and oral, as the assessment progresses. Management should take actions to correct problems identified during the assessment. The DoD OIG recommends when it is appropriate to move forward with a formal audit.

Let's look at a few of the audit steps outlined in the Planning phase and Internal Control phase of the audit manual.



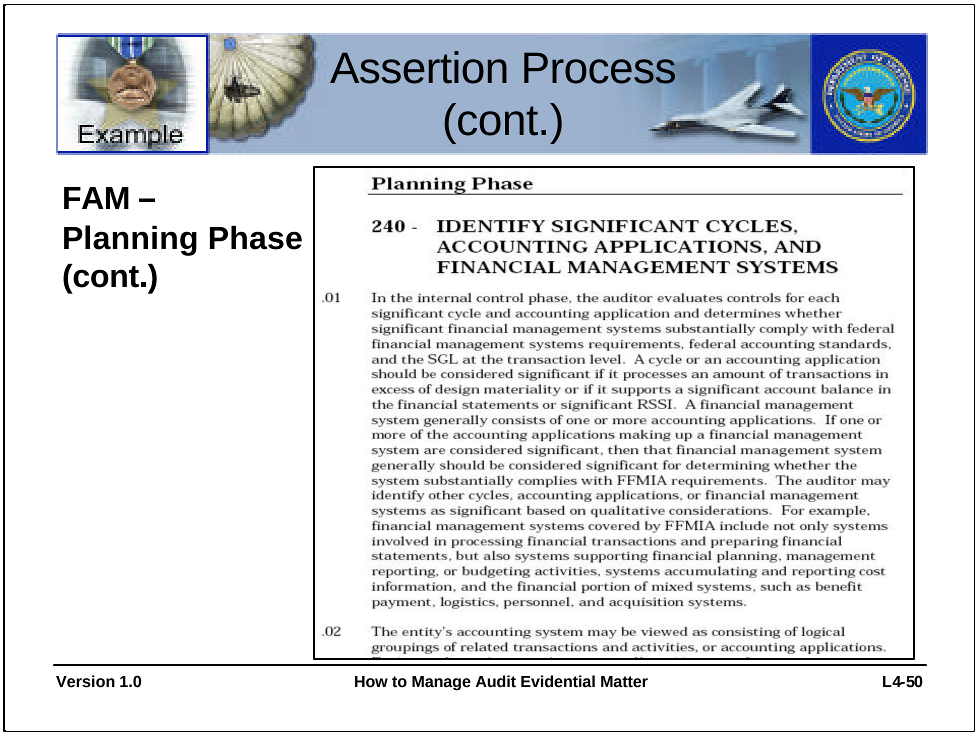
Assertion Process (cont.)

FAM – Planning Phase

200	PLANNING PHASE
210	Overview
220	Understand the Entity's Operations
225	Perform Preliminary Analytical Procedures
230	Determine Planning, Design, and Test Materiality
235	Identify Significant Line Items, Accounts, Assertions, and RSSI
240	Identify Significant Cycles, Accounting Applications, and Financial Management Systems
245	Identify Significant Provisions of Laws and Regulations
250	Identify Relevant Budget Restrictions
260	Identify Risk Factors
270	Determine Likelihood of Effective Information System Controls

The Planning phase requires auditors to gain an understanding of the entity's operations, perform preliminary analytical procedures, and determine planning, design, and test materiality. Auditors must also identify significant line items, accounts, and assertions. In gaining an understanding of the entity's operations, auditors identify significant cycles, accounting applications, and financial management systems. They also familiarize themselves with the provisions of laws and regulations, and budget restrictions. Auditors evaluate risk factors and determine the likelihood of effective information systems controls, then identify relevant operations controls to evaluate and test.

Let's consider the identification of significant cycles, accounting applications, and financial management systems as listed in this manual.



Assertion Process (cont.)

FAM – Planning Phase (cont.)

Planning Phase

240 - IDENTIFY SIGNIFICANT CYCLES, ACCOUNTING APPLICATIONS, AND FINANCIAL MANAGEMENT SYSTEMS

.01 In the internal control phase, the auditor evaluates controls for each significant cycle and accounting application and determines whether significant financial management systems substantially comply with federal financial management systems requirements, federal accounting standards, and the SGL at the transaction level. A cycle or an accounting application should be considered significant if it processes an amount of transactions in excess of design materiality or if it supports a significant account balance in the financial statements or significant RSSI. A financial management system generally consists of one or more accounting applications. If one or more of the accounting applications making up a financial management system are considered significant, then that financial management system generally should be considered significant for determining whether the system substantially complies with FFMIA requirements. The auditor may identify other cycles, accounting applications, or financial management systems as significant based on qualitative considerations. For example, financial management systems covered by FFMIA include not only systems involved in processing financial transactions and preparing financial statements, but also systems supporting financial planning, management reporting, or budgeting activities, systems accumulating and reporting cost information, and the financial portion of mixed systems, such as benefit payment, logistics, personnel, and acquisition systems.

.02 The entity's accounting system may be viewed as consisting of logical groupings of related transactions and activities, or accounting applications.

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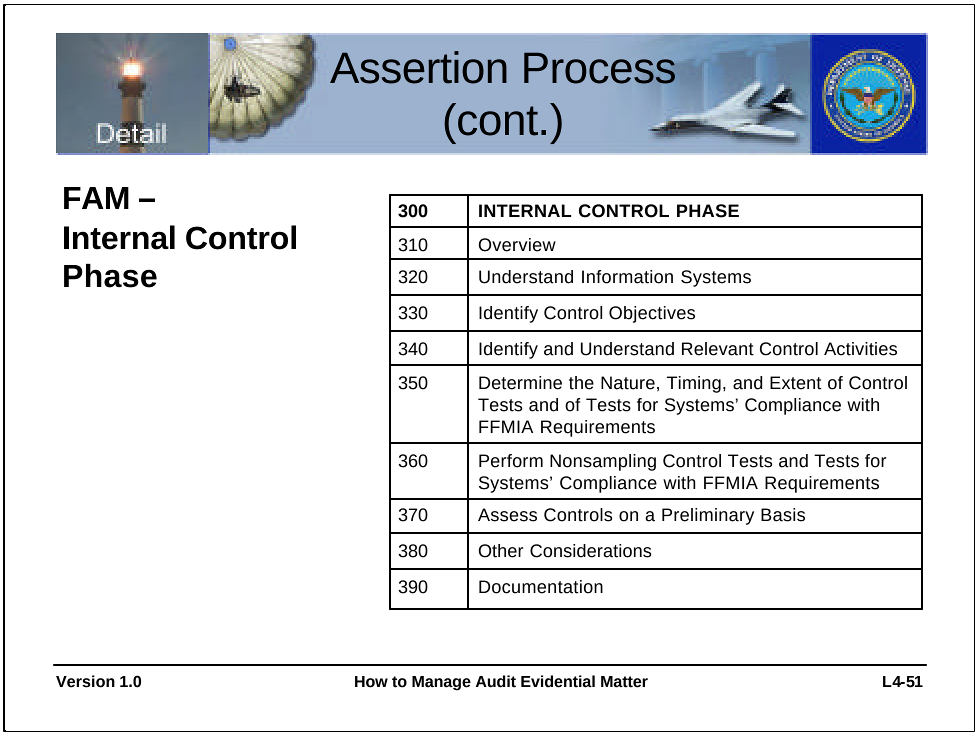
The FAM describes the identification of significant cycles, accounting applications, and financial management systems requirements by providing an overview of the auditors' duties as they relate to this item. It defines significance as it relates to each item and how the items are affected by both financial and non-financial systems.

Now let's talk about the Internal Control phase.



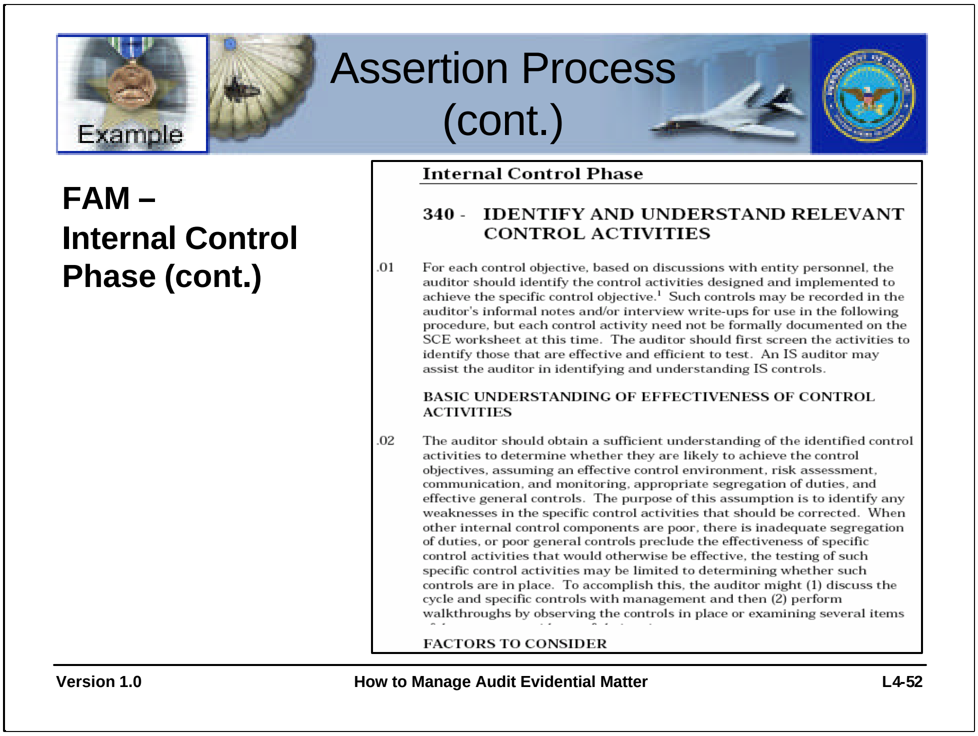
Assertion Process (cont.)

FAM – Internal Control Phase

300	**INTERNAL CONTROL PHASE**
310	Overview
320	Understand Information Systems
330	Identify Control Objectives
340	Identify and Understand Relevant Control Activities
350	Determine the Nature, Timing, and Extent of Control Tests and of Tests for Systems' Compliance with FFMIA Requirements
360	Perform Nonsampling Control Tests and Tests for Systems' Compliance with FFMIA Requirements
370	Assess Controls on a Preliminary Basis
380	Other Considerations
390	Documentation

The Internal Control phase requires auditors to gain an understanding of the entity's information systems, control objectives, and relevant control activities. They must determine the nature, timing, and extent of control tests and of tests for systems compliance with legal requirements. To determine the testing required, auditors perform control and compliance testing on a preliminary basis.

Let's take a closer look at identifying and understanding relevant control activities.



Example

Assertion Process (cont.)

FAM – Internal Control Phase (cont.)

Internal Control Phase

340 - IDENTIFY AND UNDERSTAND RELEVANT CONTROL ACTIVITIES

.01 For each control objective, based on discussions with entity personnel, the auditor should identify the control activities designed and implemented to achieve the specific control objective.[1] Such controls may be recorded in the auditor's informal notes and/or interview write-ups for use in the following procedure, but each control activity need not be formally documented on the SCE worksheet at this time. The auditor should first screen the activities to identify those that are effective and efficient to test. An IS auditor may assist the auditor in identifying and understanding IS controls.

BASIC UNDERSTANDING OF EFFECTIVENESS OF CONTROL ACTIVITIES

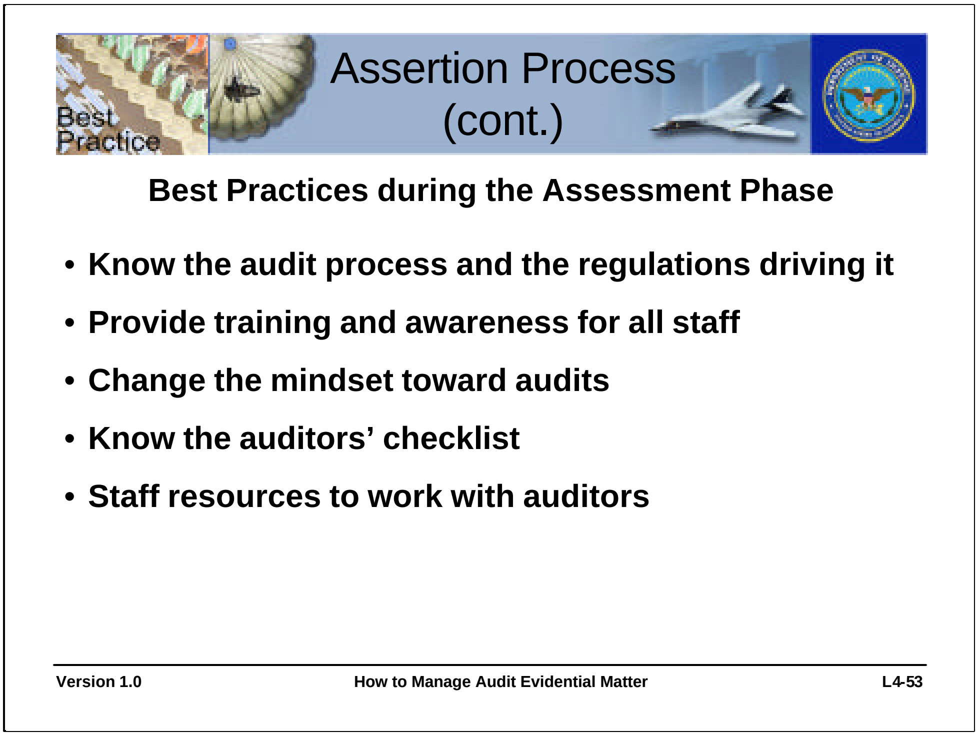
.02 The auditor should obtain a sufficient understanding of the identified control activities to determine whether they are likely to achieve the control objectives, assuming an effective control environment, risk assessment, communication, and monitoring, appropriate segregation of duties, and effective general controls. The purpose of this assumption is to identify any weaknesses in the specific control activities that should be corrected. When other internal control components are poor, there is inadequate segregation of duties, or poor general controls preclude the effectiveness of specific control activities that would otherwise be effective, the testing of such specific control activities may be limited to determining whether such controls are in place. To accomplish this, the auditor might (1) discuss the cycle and specific controls with management and then (2) perform walkthroughs by observing the controls in place or examining several items

FACTORS TO CONSIDER

Relevant control activities are described as those that are designed to achieve the specific control objective. The auditors first screen the activities to identify those objectives that are effective and efficient to test in an effort to obtain a sufficient understanding of the identified control activities. The auditors must determine whether they are likely to achieve the control objectives, assuming an effective control environment, risk assessment, communications, monitoring, appropriate segregation of duties, and effective general controls.

The auditors identify any weaknesses in specific control activities that should be corrected. When internal control components are poor, there is inadequate segregation of duties, or poor general controls preclude the effectiveness of specific control activities that would otherwise be effective, the testing of these control activities may be limited to determining whether they are in place.

Let’s examine a few practices that are particularly useful in the Assessment phase.


Best
Practice

Assertion Process (cont.)

Best Practices during the Assessment Phase

- **Know the audit process and the regulations driving it**
- **Provide training and awareness for all staff**
- **Change the mindset toward audits**
- **Know the auditors' checklist**
- **Staff resources to work with auditors**

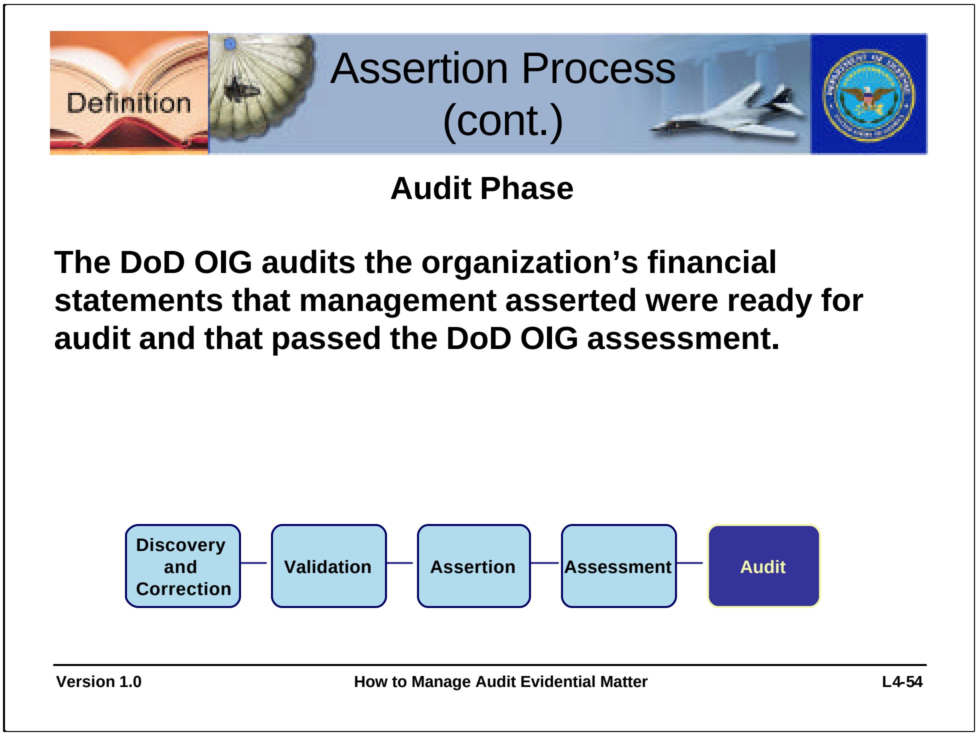
If you know the audit process and the regulations driving it, you can anticipate the auditor's requirements. It is important that good training and awareness for all staff is provided in your assessment strategy. With adequate training on what is expected, you ensure that your people are ready for the audit.

You must lead a change in the mindset toward audits; they are not just for the financial community. You may set up a web site or have a newsletter. Frequent communication is necessary to convey expectations, goals, and direction.

When the auditors examine entity operations, you should know the auditors' checklist. You can then anticipate what is going to be needed and start early to have the audit move quickly and have less disruption of business operations.

Successful organizations ensure that they have adequate resources in place to assist in the audit effort. You must assign resources to work with auditors or hire contractors.

Let's move on to the Audit phase.


Definition

Assertion Process (cont.)

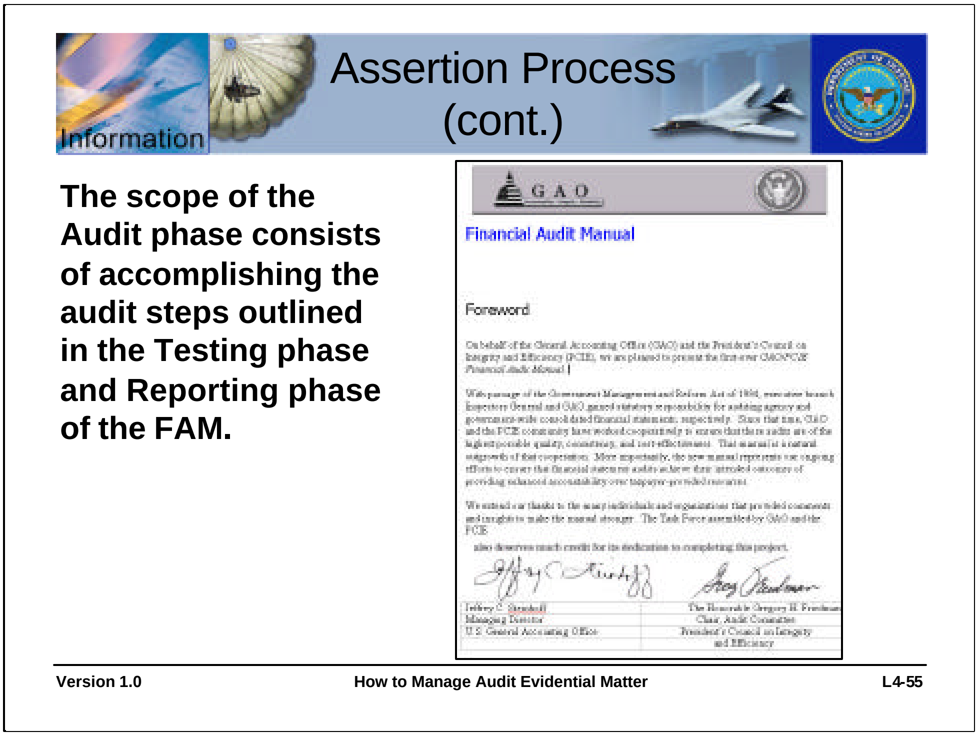
Audit Phase

The DoD OIG audits the organization’s financial statements that management asserted were ready for audit and that passed the DoD OIG assessment.

Discovery and Correction — Validation — Assertion — Assessment — **Audit**

The purpose of the Audit phase is to obtain the auditors’ opinion of the condition of an entity’s financial statements or line. The purpose of this phase is also to obtain the auditors’ opinion of the fairness of the presentation of the information in the financial statements. When a financial statement or portion thereof is asserted to be ready for audit and has passed assessment, or assessment has been waived, the DoD OIG determines the appropriate scope and nature for a financial audit and the associated reports.

Let’s learn more about this phase.



Assertion Process (cont.)

The scope of the Audit phase consists of accomplishing the audit steps outlined in the Testing phase and Reporting phase of the FAM.

Financial Audit Manual

Foreword

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Jeffrey C. Steinhoff	The Honorable Gregory H. Friedman
Managing Director	Chair, Audit Committee
U.S. General Accounting Office	President's Council on Integrity and Efficiency

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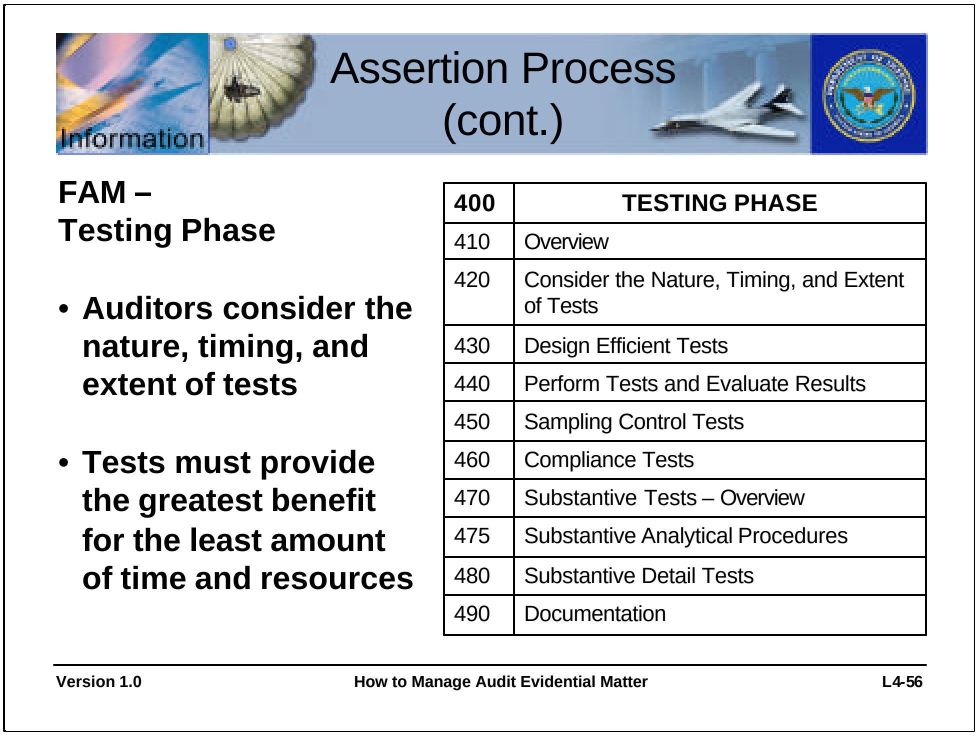
During the Audit phase, the entity and its accounting records are audited to determine if the balances and related notes presented on its financial statements fairly represent the operations of the entity.

With the assistance of the DoD OIG, DoD reporting entities prepare detailed engagement letters requesting audit services. The auditors then require any management representations made to date that concern the items to be included in the audit. DoD reporting entities prepare as many interim management representation letters as necessary to include any additional assertions required by the audit. They then prepare a final management representation letter.

Management personnel address deficiencies with a written plan for resolution, including projected resolution date. The DoD OIG intervenes if necessary to end the audit and recommends a follow-up assessment upon indication that the audit may not have a favorable outcome.

The scope of the Audit phase consists of accomplishing the audit steps outlined in the Testing phase and Reporting phase of the audit manual.

Let’s look at a few of these steps.


Information

Assertion Process (cont.)

FAM – Testing Phase

- **Auditors consider the nature, timing, and extent of tests**
- **Tests must provide the greatest benefit for the least amount of time and resources**

400	**TESTING PHASE**
410	Overview
420	Consider the Nature, Timing, and Extent of Tests
430	Design Efficient Tests
440	Perform Tests and Evaluate Results
450	Sampling Control Tests
460	Compliance Tests
470	Substantive Tests – Overview
475	Substantive Analytical Procedures
480	Substantive Detail Tests
490	Documentation

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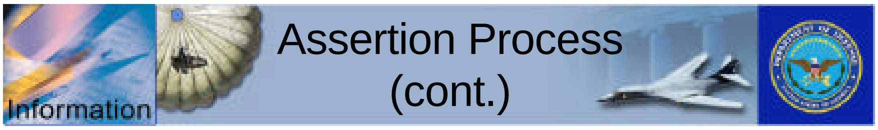
The Testing phase consists of a consideration of the nature, timing, and extent of tests to be performed on the evidentiary matter associated with the audit. The auditors must design efficient tests that provide the greatest benefit for the least amount of time and resources. The auditors must then perform those tests and evaluate results. Several types of testing are available and are explained within the FAM.

Once testing is completed, the auditors must document the results in order to ensure that adequate audit procedures have been accomplished.

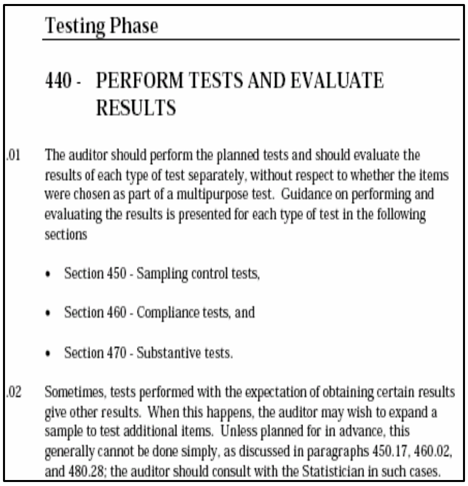
Let’s look at the requirement for performing tests and evaluating results.



Assertion Process (cont.)

FAM – Testing Phase (cont.)

- **Tests should evaluate the results of each type of test separately**
- **Tests performed with the expectation of obtaining certain results may give other results**



Testing Phase

440 - PERFORM TESTS AND EVALUATE RESULTS

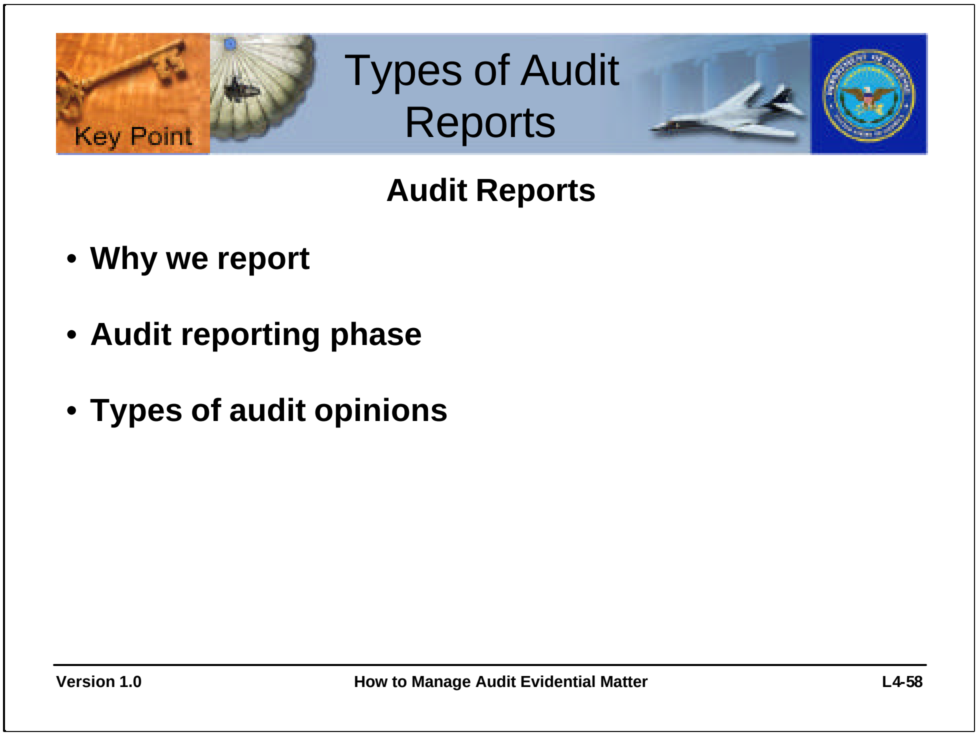
.01 The auditor should perform the planned tests and should evaluate the results of each type of test separately, without respect to whether the items were chosen as part of a multipurpose test. Guidance on performing and evaluating the results is presented for each type of test in the following sections

- Section 450 - Sampling control tests,
- Section 460 - Compliance tests, and
- Section 470 - Substantive tests.

.02 Sometimes, tests performed with the expectation of obtaining certain results give other results. When this happens, the auditor may wish to expand a sample to test additional items. Unless planned for in advance, this generally cannot be done simply, as discussed in paragraphs 450.17, 460.02, and 480.28; the auditor should consult with the Statistician in such cases.

The FAM states that the auditors should perform the planned tests and evaluate the results of each type of test separately, without respect to whether the items were chosen as part of a multipurpose test. It states that sometimes, tests performed with the expectation of obtaining certain results give other results. When this happens, the auditors may wish to expand a sample to test additional items. Unless planned for in advance, this generally cannot be done simply and the auditors should consult with a statistician.

Although the Reporting phase is captured within the final phase of the Financial Improvement Initiatives Business Rules, let's begin the discussion of the Reporting phase with a discussion of the types of audit reports.



Key Point

Types of Audit Reports

Audit Reports

- **Why we report**
- **Audit reporting phase**
- **Types of audit opinions**

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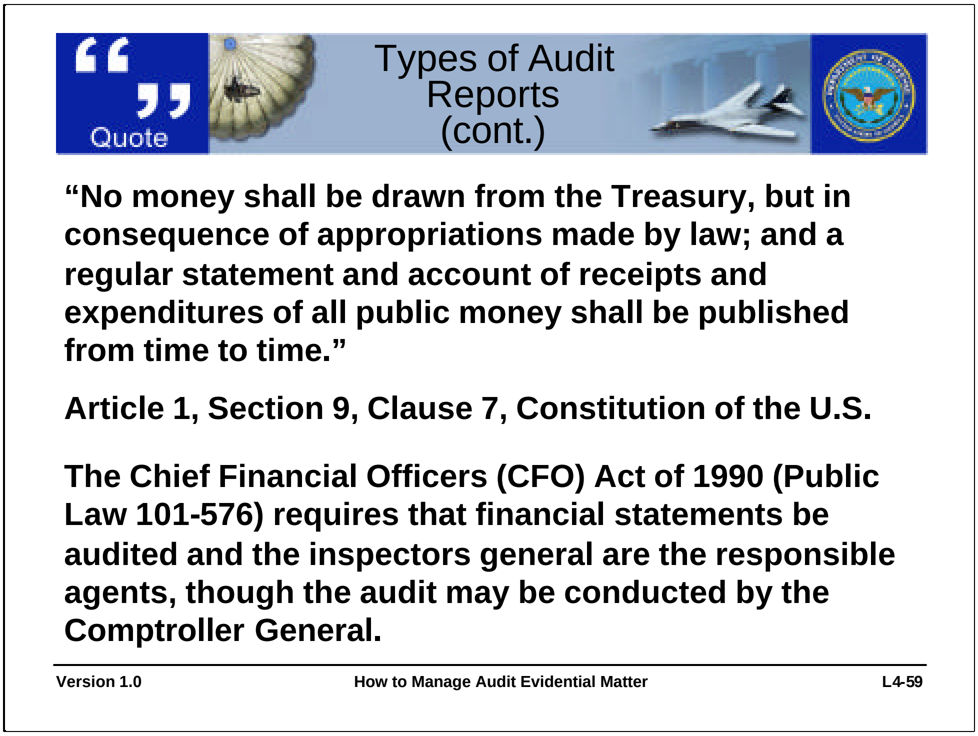
In this topic, you are exposed to the various types of audit reports and typical examples for their use. First we will discuss the requirement for reporting and the types of audits that are reported on. Then we will discuss the requirements of the financial audit reporting phase. We will talk about the standard auditors' report and what is meant by the specific language used in that report. Finally, we will discuss the types of audit opinions that may be seen on an audit report.

Now let's discuss why we report.



Quote

Types of Audit Reports (cont.)

“No money shall be drawn from the Treasury, but in consequence of appropriations made by law; and a regular statement and account of receipts and expenditures of all public money shall be published from time to time.”

Article 1, Section 9, Clause 7, Constitution of the U.S.

The Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576) requires that financial statements be audited and the inspectors general are the responsible agents, though the audit may be conducted by the Comptroller General.

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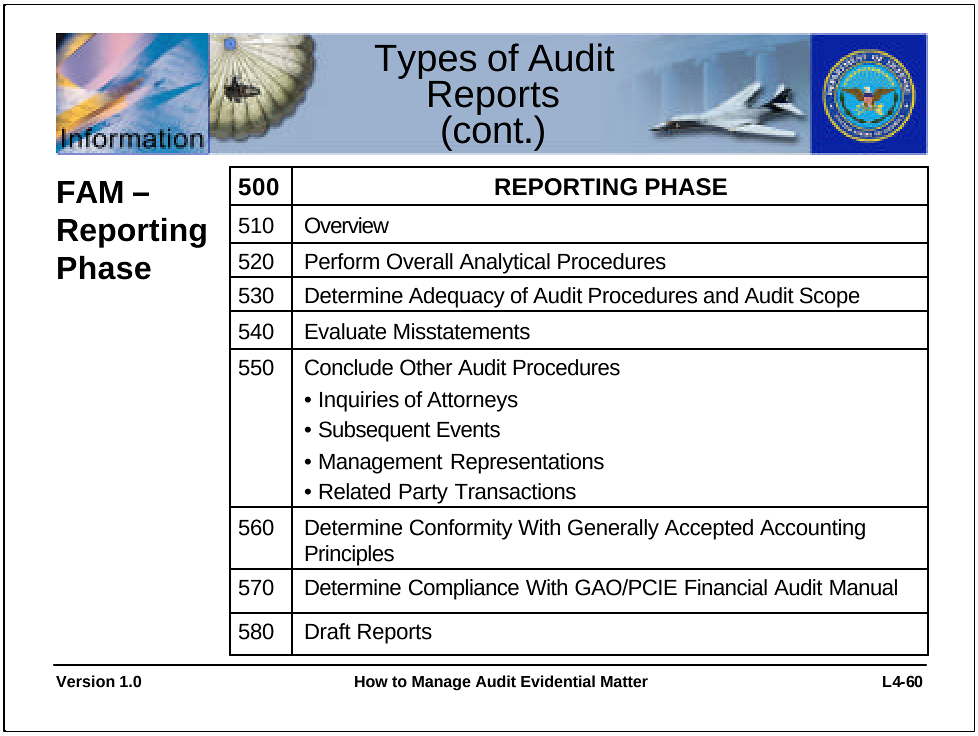
The accountability clause of the U.S. Constitution (Article I, Section 9, Clause 7) links the legal expenditure of appropriations to the reporting of transaction information and account balances. The CFOA of 1990 (Public Law 101-576) requires that financial statements be audited and the inspectors general are the responsible agents, though the audit may be conducted by the Comptroller General. What this means to you is that there is a long history for the requirement to report on the use of resources. Up to 1990, that reporting did not receive an audit.

When we properly control and account for the resources used at every level of our operations, and ensure that the data used to inform our leaders on the status of their resources is reliable and timely, we provide them with the means to make informed decisions.

How many of you would invest in a company with a budget of over $400 billion that cannot obtain a favorable audit opinion? We establish credibility and trust when we obtain a favorable opinion on a financial statements audit, and it’s the responsibility of the government to it’s citizens to ensure that trust. Ensuring the public trust is also the foundation for many of our laws.

Let’s examine the requirements from the GAO/PCIE FAM for the reporting phase of the financial audit.


Information

Types of Audit Reports (cont.)

FAM – Reporting Phase

500	REPORTING PHASE
510	Overview
520	Perform Overall Analytical Procedures
530	Determine Adequacy of Audit Procedures and Audit Scope
540	Evaluate Misstatements
550	Conclude Other Audit Procedures • Inquiries of Attorneys • Subsequent Events • Management Representations • Related Party Transactions
560	Determine Conformity With Generally Accepted Accounting Principles
570	Determine Compliance With GAO/PCIE Financial Audit Manual
580	Draft Reports

According to the GAO/PCIE FAM, the Reporting phase requires the auditors to perform overall analytical procedures. This does not mean that all testing must be re-done, but that the results of all of the testing must be analyzed in order to formulate conclusions. The auditors must also determine the adequacy of audit procedures and the audit scope in the formulation of these conclusions.

Misstatements are evaluated for their severity. If material, they may affect the overall opinion of the auditors. Other audit procedures include inquiries of the attorneys who represent the entity. Auditors must determine whether there are any pending liabilities that were not adequately disclosed in the notes to the financial statements.

The auditors must determine whether the presentation of the financial statements is in conformity with GAAP and whether the entity is in compliance with the FAM. The auditors then draft reports on the financial statements, internal control, financial management systems, and compliance with laws and regulations. The draft reports are used during the discussion of audit findings during the exit conference, though most items will have already been addressed throughout the audit.

Let’s expand on the drafting of these reports.

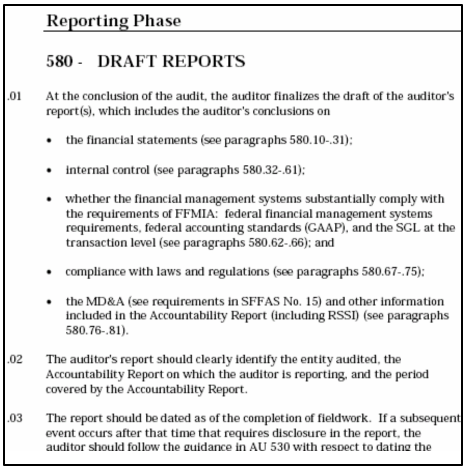
Information

Types of Audit Reports (cont.)

FAM –
Reporting Phase (cont.)

Financial audit reports include conclusions on:

- **The financial statements**
- **Internal control**
- **Compliance with laws, requirements, and standards**



Reporting Phase

580 - DRAFT REPORTS

.01 At the conclusion of the audit, the auditor finalizes the draft of the auditor's report(s), which includes the auditor's conclusions on

- the financial statements (see paragraphs 580.10-.31);
- internal control (see paragraphs 580.32-.61);
- whether the financial management systems substantially comply with the requirements of FFMIA: federal financial management systems requirements, federal accounting standards (GAAP), and the SGL at the transaction level (see paragraphs 580.62-.66); and
- compliance with laws and regulations (see paragraphs 580.67-.75);
- the MD&A (see requirements in SFFAS No. 15) and other information included in the Accountability Report (including RSSI) (see paragraphs 580.76-.81).

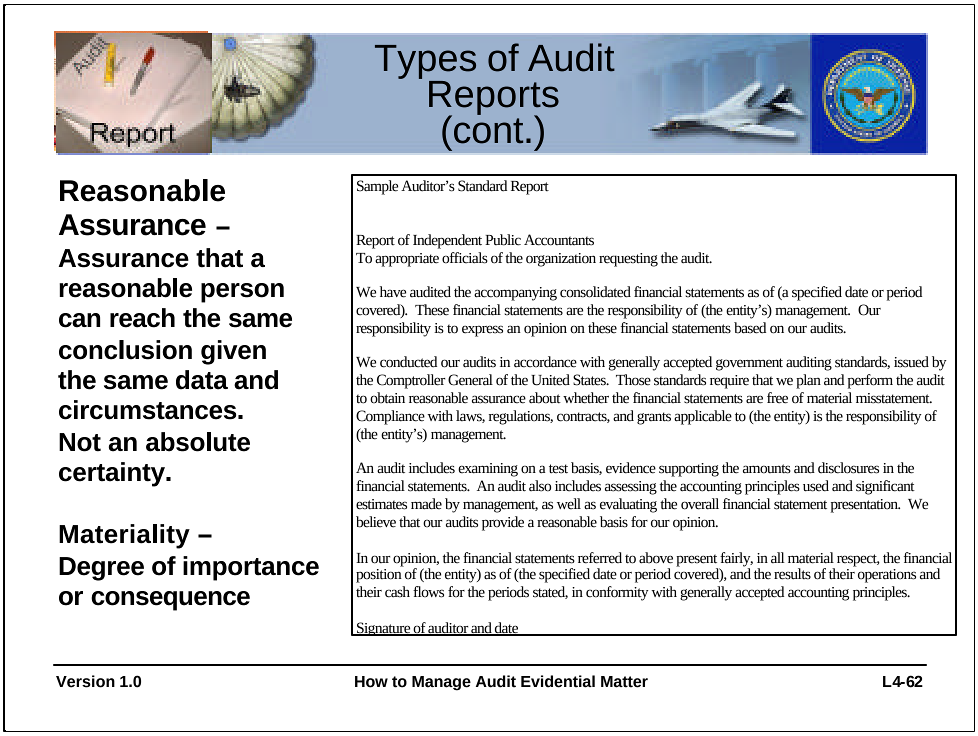
.02 The auditor's report should clearly identify the entity audited, the Accountability Report on which the auditor is reporting, and the period covered by the Accountability Report.

.03 The report should be dated as of the completion of fieldwork. If a subsequent event occurs after that time that requires disclosure in the report, the auditor should follow the guidance in AU 530 with respect to dating the

At the conclusion of the audit, the auditors finalize the draft of the auditors' reports. They include the auditors' conclusions on the financial statements, internal control, and system compliance with requirements of the FFMIA, federal financial management systems requirements, federal accounting standards, and the USSGL at the transaction level. They also include the auditors' conclusions on the entity's compliance with laws and regulations.

The auditors' report should clearly identify the entity audited, the accountability report on which the auditors are reporting, and the period covered by the accountability report. It should then be dated as of the completion of fieldwork.

Let's look at a standard audit report and what it means.



Audit
Report

Types of Audit Reports (cont.)

Reasonable Assurance – Assurance that a reasonable person can reach the same conclusion given the same data and circumstances. Not an absolute certainty.

Materiality – Degree of importance or consequence

Sample Auditor's Standard Report

Report of Independent Public Accountants
To appropriate officials of the organization requesting the audit.

We have audited the accompanying consolidated financial statements as of (a specified date or period covered). These financial statements are the responsibility of (the entity's) management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted government auditing standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Compliance with laws, regulations, contracts, and grants applicable to (the entity) is the responsibility of (the entity's) management.

An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respect, the financial position of (the entity) as of (the specified date or period covered), and the results of their operations and their cash flows for the periods stated, in conformity with generally accepted accounting principles.

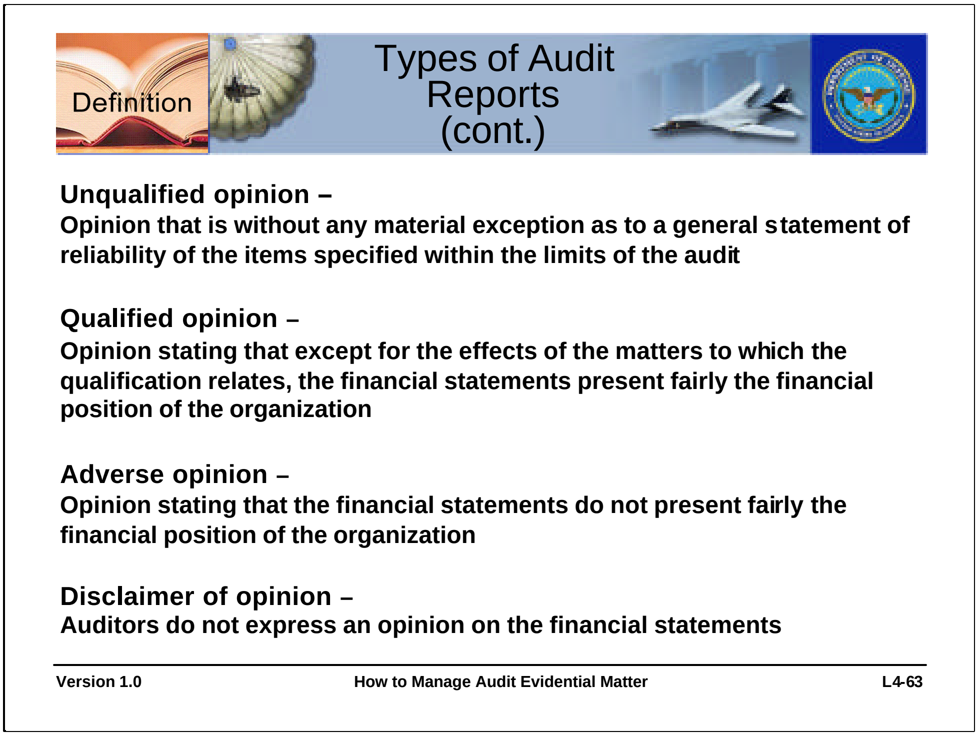
Signature of auditor and date

The standard auditors' report describes the limits of the auditors' responsibility, how they formed an opinion, and the stated opinion. Notice that the auditors' opinion is based on reasonable assurance, as opposed to certainty. The prescribed language of the audit report ensures that the auditors define the limits of their assurance. The auditors must test on a sample basis enough evidential matter to reasonably assure that the financial statements present fairly, in all material respects, the financial position of the organization being audited.

By using the phrase "in all material respects," the auditors state the degree to which the information may be relied upon. The concept of materiality allows that minor deviations in account balances or procedures may have no effect on the reliability of the statements as a whole (for example, a hundred dollar deviation on a million dollar account balance). Using this same concept, it is possible that the auditors' opinion may be qualified by an amount or procedure that does in some way affect the reliability of the financial statements (for example, that hundred dollar deviation had to do with a trend that if not corrected would have a major effect on the financial statements). A material weakness is a weakness in management controls that warrants reporting to a higher level.

There are specified amounts that are considered material depending on the type of account or activity. The auditors set the materiality at the beginning of the audit. This is done for each audit.

Let's consider the various types of audit opinions.



Definition

Types of Audit Reports (cont.)

Unqualified opinion –
Opinion that is without any material exception as to a general statement of reliability of the items specified within the limits of the audit

Qualified opinion –
Opinion stating that except for the effects of the matters to which the qualification relates, the financial statements present fairly the financial position of the organization

Adverse opinion –
Opinion stating that the financial statements do not present fairly the financial position of the organization

Disclaimer of opinion –
Auditors do not express an opinion on the financial statements

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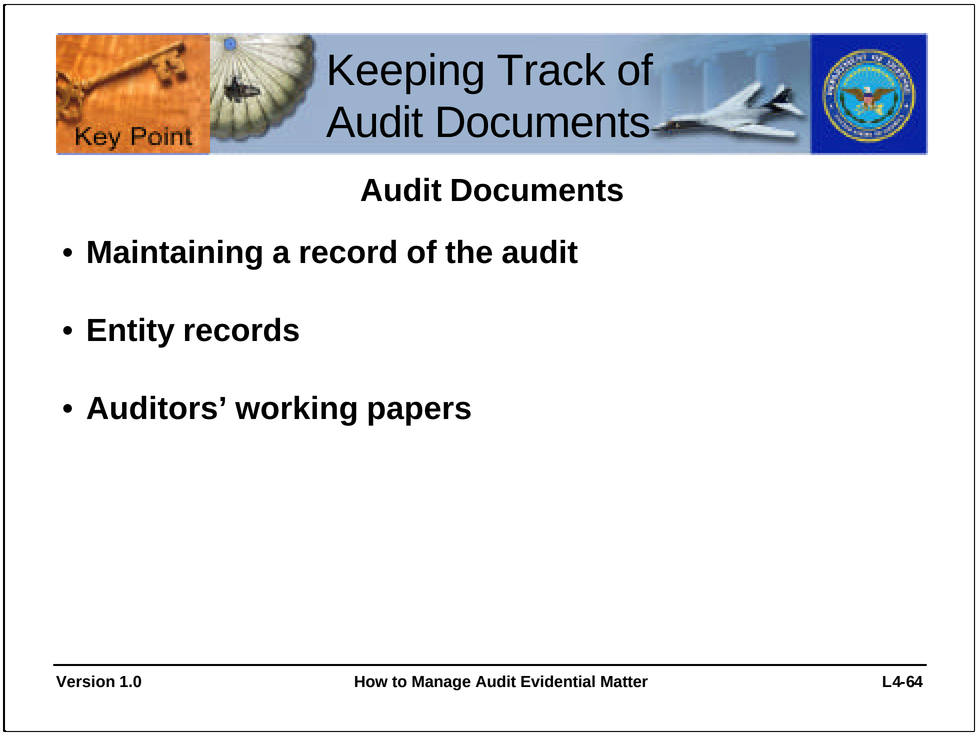
An unqualified opinion is the most preferred finding. An unqualified opinion has no material exception as to a general statement of reliability. Any other opinion is deemed to be a result of one or more material departures from the GAAP, or the auditors have been unable to obtain sufficient evidence regarding one or more of the management's assertions, and as a result do not have a reasonable basis for an unqualified opinion on the financial statements as a whole.

A qualified opinion states that except for the effects of the matters to which the qualification relates, the financial statements fairly present the financial position of the organization. An adverse opinion states that the financial statements do not fairly present the financial position of the organization. A disclaimer of opinion which states that the auditors do not express an opinion on the financial statements.

To be eligible for an unqualified audit opinion, the financial statements must be fully auditable and compiled in accordance with generally accepted accounting principles. That means that the underlying data and procedures must be sufficient, accurate, testable, and reliable enough for the auditors to obtain a basis for forming an unqualified opinion.

Now that you are familiar with the types of audit reports, let's discuss keeping track of audit documents.



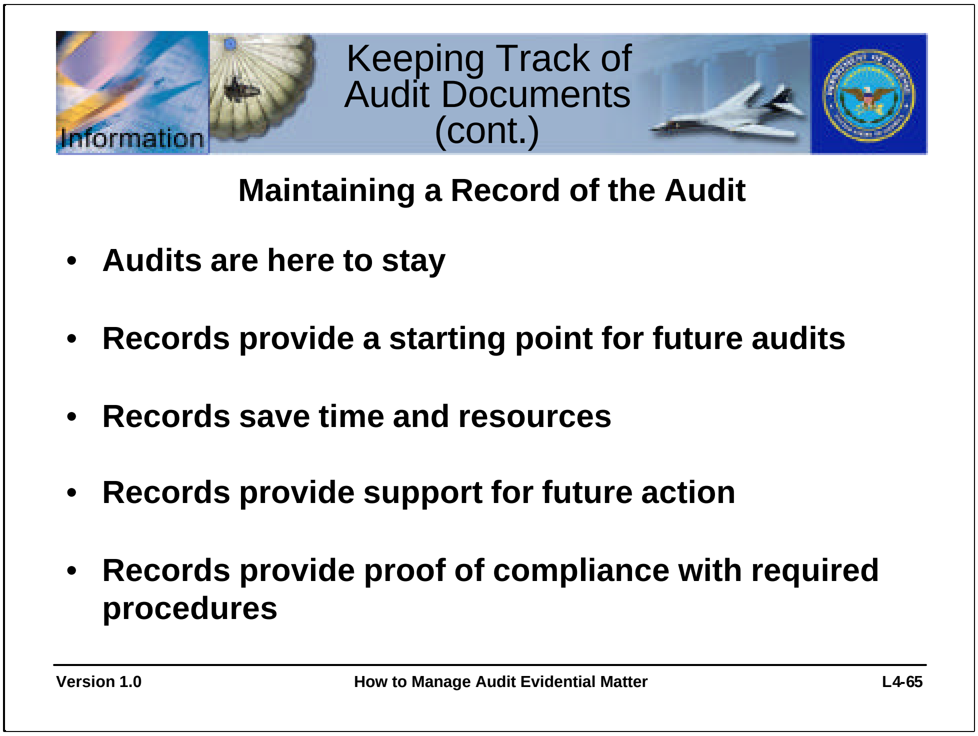
Keeping Track of Audit Documents

Audit Documents

- **Maintaining a record of the audit**
- **Entity records**
- **Auditors' working papers**

In this topic, you are given examples of various types of audit documents and the procedures used to keep track of them both during and at the conclusion of the audit process. You are then shown an example of the auditors' working papers and an explanation of the differences between your audit documentation and the documentation maintained by the auditors.

Let's begin by looking at why we maintain a record of the audit.



Information

Keeping Track of Audit Documents (cont.)

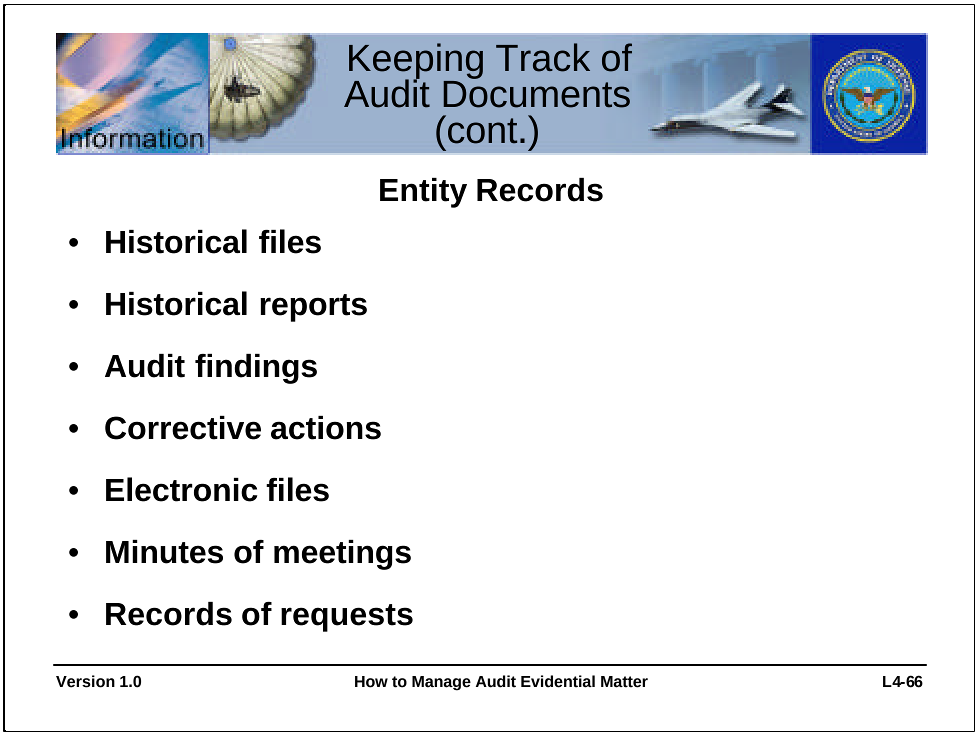
Maintaining a Record of the Audit

- **Audits are here to stay**
- **Records provide a starting point for future audits**
- **Records save time and resources**
- **Records provide support for future action**
- **Records provide proof of compliance with required procedures**

Audits are here to stay. It is important to maintain a record of the audit to provide a starting point for future audits, to save time and resources, and to support future action.

Records also provide proof of compliance with required procedures by the auditors in the conduct of the audit.

Let’s consider the kinds of audit documents that are maintained by the entity.


Information

Keeping Track of Audit Documents (cont.)

Entity Records

- **Historical files**
- **Historical reports**
- **Audit findings**
- **Corrective actions**
- **Electronic files**
- **Minutes of meetings**
- **Records of requests**

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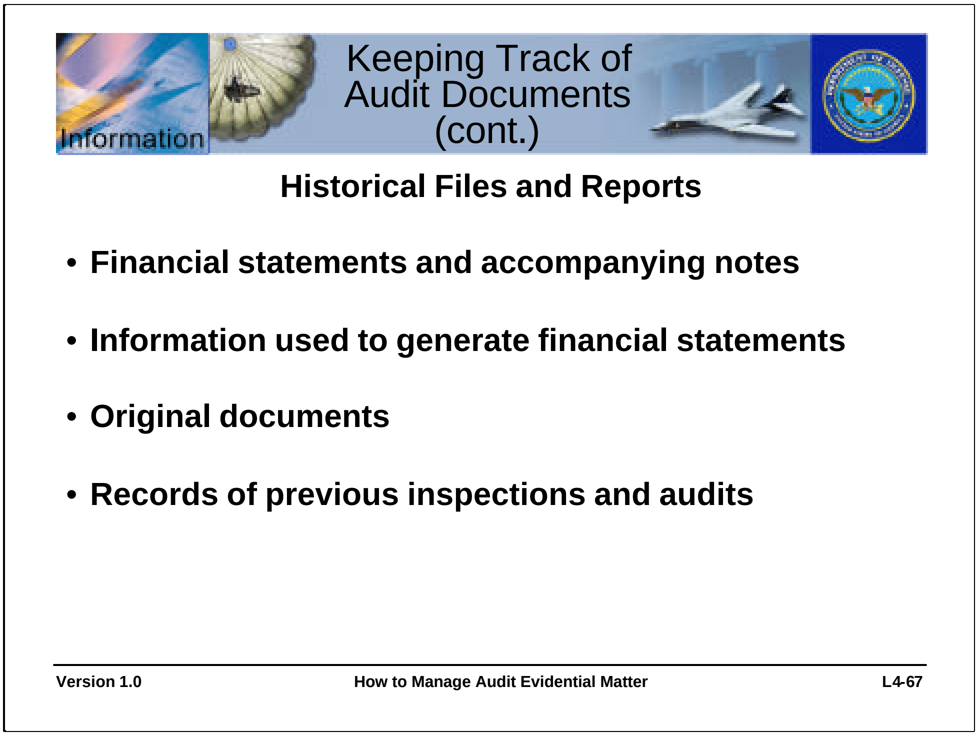
Entity audit documents include historical files and reports such as financial statements, original documents, and inspection or audit reports. Audit findings and corrective actions are also included in the audit documentation.

The entity also maintains electronic files for the retrieval of audit documents. These documents may include minutes of audit committee meetings, schedules, and notes.

A record of requests by the auditors is particularly helpful in planning for future audit requirements.

Let’s begin with a look at historical files and reports.


Information

Keeping Track of Audit Documents (cont.)

Historical Files and Reports

- **Financial statements and accompanying notes**
- **Information used to generate financial statements**
- **Original documents**
- **Records of previous inspections and audits**

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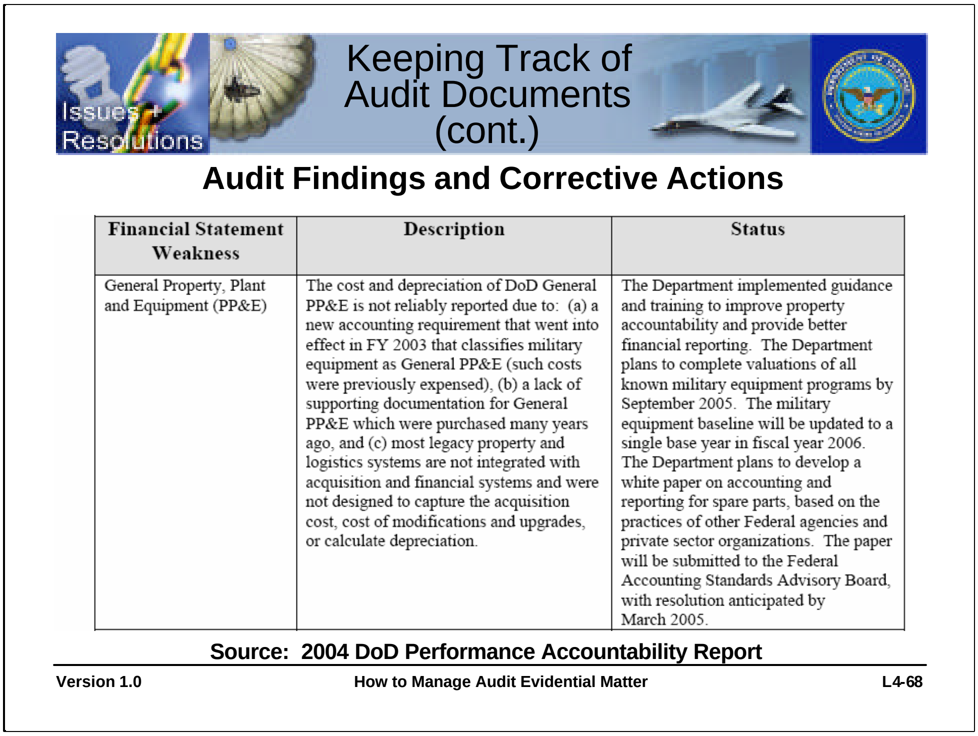
Historical documents that are difficult to regenerate, are required to be in original form, or may be needed on future audits require special handling. This may include identification of the documents to a records holding area with instructions for its maintenance and retrieval. Electronic records holding areas may also be used when original documents are not required. These may include financial statements and accompanying notes, files, reports, and spreadsheets that were used in the compilation of the financial statements that may no longer exist in their present form when more current data enters the financial systems. Documents containing original signatures that are required as proof of ownership, agreement, or liability may be required to be maintained in original form.

You must maintain records of previous audits and inspections. Although the normal retention period of these files may extend only for the normal retention period for financial records of six years and three months, they should be maintained at a minimum until the next similar inspection in which any identified deficiency has been found to be corrected, or until outstanding issues are resolved.

Audit findings and corrective action are examples of outstanding issues. Let’s examine an audit finding and the corresponding corrective action as listed on the 2004 DoD Performance Accountability Report (PAR).


Issues + Resolutions

Keeping Track of Audit Documents (cont.)

Audit Findings and Corrective Actions

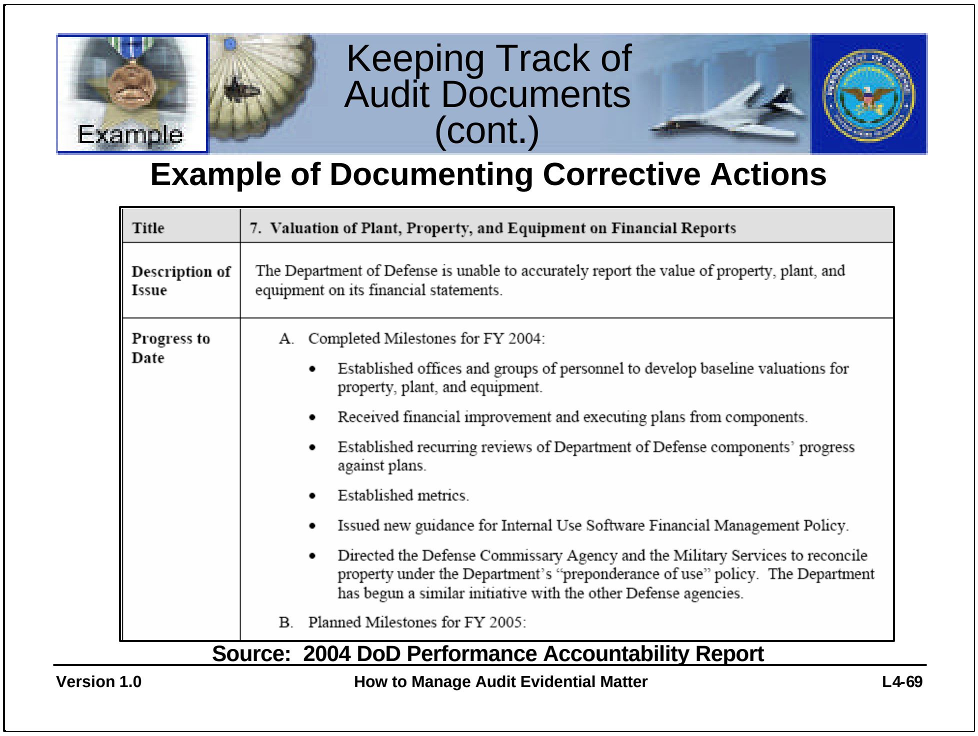
Financial Statement Weakness	Description	Status
General Property, Plant and Equipment (PP&E)	The cost and depreciation of DoD General PP&E is not reliably reported due to: (a) a new accounting requirement that went into effect in FY 2003 that classifies military equipment as General PP&E (such costs were previously expensed), (b) a lack of supporting documentation for General PP&E which were purchased many years ago, and (c) most legacy property and logistics systems are not integrated with acquisition and financial systems and were not designed to capture the acquisition cost, cost of modifications and upgrades, or calculate depreciation.	The Department implemented guidance and training to improve property accountability and provide better financial reporting. The Department plans to complete valuations of all known military equipment programs by September 2005. The military equipment baseline will be updated to a single base year in fiscal year 2006. The Department plans to develop a white paper on accounting and reporting for spare parts, based on the practices of other Federal agencies and private sector organizations. The paper will be submitted to the Federal Accounting Standards Advisory Board, with resolution anticipated by March 2005.

Source: 2004 DoD Performance Accountability Report

The PAR includes sections on Management Discussion and Analysis, Performance Information, Financial Information, and Auditors' Reports. Part of the Management Discussion and Analysis includes compliance with legislation that requires the disclosure of deficiencies that may affect the entity's ability to accurately report on its financial position.

The PAR represents a compilation of documents that provide a record of the entity's performance, including its audit performance. The example shows how the Department provides information on identified weaknesses and their current status.

Let's look at the progress toward correcting this weakness as annotated in the PAR.



Keeping Track of Audit Documents (cont.)

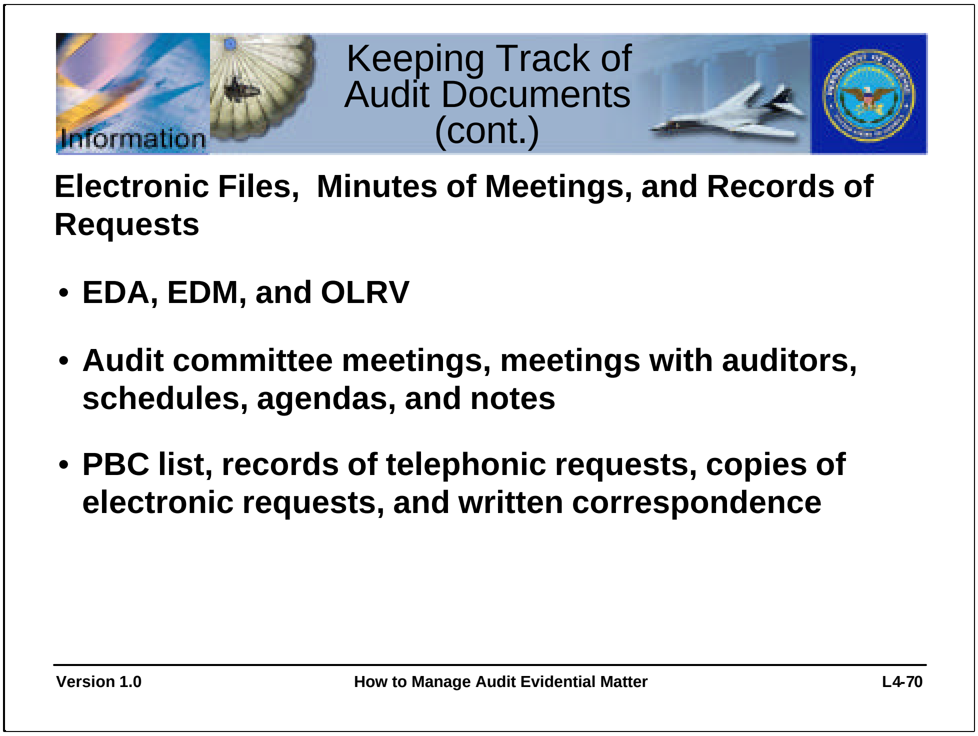
Example of Documenting Corrective Actions

Title	7. Valuation of Plant, Property, and Equipment on Financial Reports
Description of Issue	The Department of Defense is unable to accurately report the value of property, plant, and equipment on its financial statements.
Progress to Date	A. Completed Milestones for FY 2004: • Established offices and groups of personnel to develop baseline valuations for property, plant, and equipment. • Received financial improvement and executing plans from components. • Established recurring reviews of Department of Defense components' progress against plans. • Established metrics. • Issued new guidance for Internal Use Software Financial Management Policy. • Directed the Defense Commissary Agency and the Military Services to reconcile property under the Department's "preponderance of use" policy. The Department has begun a similar initiative with the other Defense agencies. B. Planned Milestones for FY 2005:

Source: 2004 DoD Performance Accountability Report

Notice that the weakness is summarized and progress to date is annotated. Once the weakness is corrected, it is listed on the PAR in an area designated for corrected weaknesses. In this way, a record is maintained of actions planned and implemented until a final resolution is obtained.

Now let's look at a few more audit documents and how they are maintained.


Information

Keeping Track of Audit Documents (cont.)

Electronic Files, Minutes of Meetings, and Records of Requests

- **EDA, EDM, and OLRV**
- **Audit committee meetings, meetings with auditors, schedules, agendas, and notes**
- **PBC list, records of telephonic requests, copies of electronic requests, and written correspondence**

File retrieval tools such as EDA, EDM, and OLRV are used in the retrieval of audit evidential matter. The use of electronic media has greatly enhanced the ability of the Department to access, manage, and view required documents and reports.

The maintenance of minutes of audit committee meetings and meetings with auditors, schedules, agendas, and notes is also enhanced by the use of audit folders and files that are maintained electronically. The use of electronic files keeps the notes organized and provides ready access for the planning of future audits.

Records of requests by auditors are maintained for use in planning resources required for future audits, preparing for similar requests, and in checking current information that may be similarly requested.

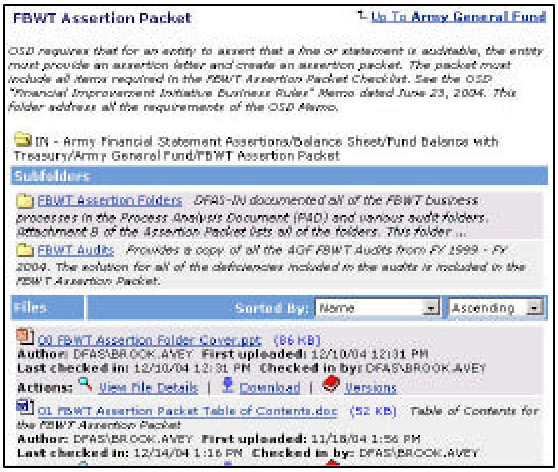
Let’s look at an example audit documents maintained in electronic folders.

Best Practice

Keeping Track of Audit Documents (cont.)

Develop a method of organized folders.

Some financial statements assertions are being put on the DFAS ePortal.


FBWT Assertion Packet Up To Army General Fund

OSD requires that for an entity to assert that a line or statement is auditable, the entity must provide an assertion letter and create an assertion packet. The packet must include all items required in the FBWT Assertion Packet Checklist. See the OSD "Financial Improvement Initiative Business Rules" Memo dated June 23, 2004. This folder address all the requirements of the OSD Memo.

IN - Army Financial Statement Assertions/Balance Sheet/Fund Balance with Treasury/Army General Fund/FBWT Assertion Packet

FBWT Assertion Folders *DFAS-IN documented all of the FBWT business processes in the Process Analysis Document (PAD) and various audit folders. Attachment B of the Assertion Packet lists all of the folders. This folder ...*

FBWT Audits *Provides a copy of all the AGF FBWT Audits from FY 1999 - FY 2004. The solution for all of the deficiencies included in the audits is included in the FBWT Assertion Packet.*

00 FBWT Assertion Folder Cover.ppt (86 KB)
Author: DFAS\BROOK.AVEY **First uploaded:** 12/10/04 12:31 PM
Last checked in: 12/10/04 12:31 PM **Checked in by:** DFAS\BROOK.AVEY
Actions: View File Details | Download | Versions

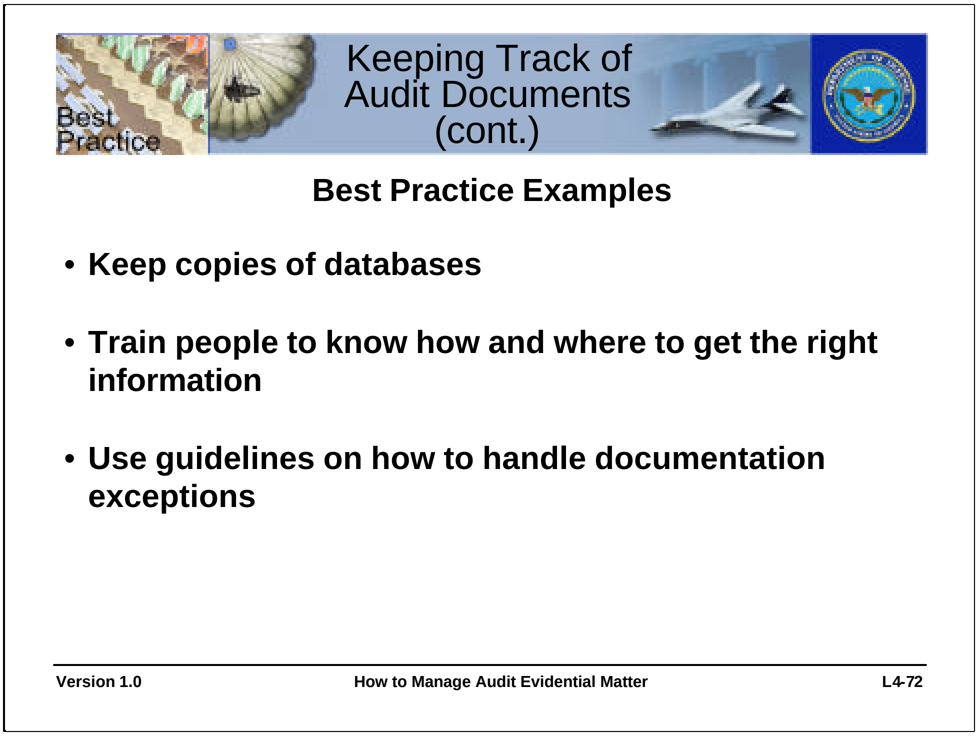
01 FBWT Assertion Packet Table of Contents.doc (52 KB) *Table of Contents for the FBWT Assertion Packet*
Author: DFAS\BROOK.AVEY **First uploaded:** 11/18/04 1:56 PM
Last checked in: 12/14/04 1:16 PM **Checked in by:** DFAS\BROOK.AVEY

Some financial statements assertions and audits are being put on the DFAS ePortal and are examples of files maintained in electronic folders to provide ready access for the audit effort. Folders are set up for each of the affected financial statements. Within each statement folder, subfolders are set up for various line items such as Accounts Payable, Cash, and Fund Balance with Treasury (FBWT).

Each line item is further subdivided by fund or other applicable division. In the case of FBWT, it is subdivided into folders for the General Fund and the Working Capital Fund. Once the fund is selected, a subfolder containing FBWT assertion packet information may be opened.

Subfolders in this area are divided into assertion files and audit files. Assertion files include a table of contents file and numbered files that are labeled by section and title. Audit files are labeled by agency and title or report number of the audit reports.

Now let's discuss a few examples of best practices.



Keeping Track of Audit Documents (cont.)

Best Practice

Best Practice Examples

- **Keep copies of databases**
- **Train people to know how and where to get the right information**
- **Use guidelines on how to handle documentation exceptions**

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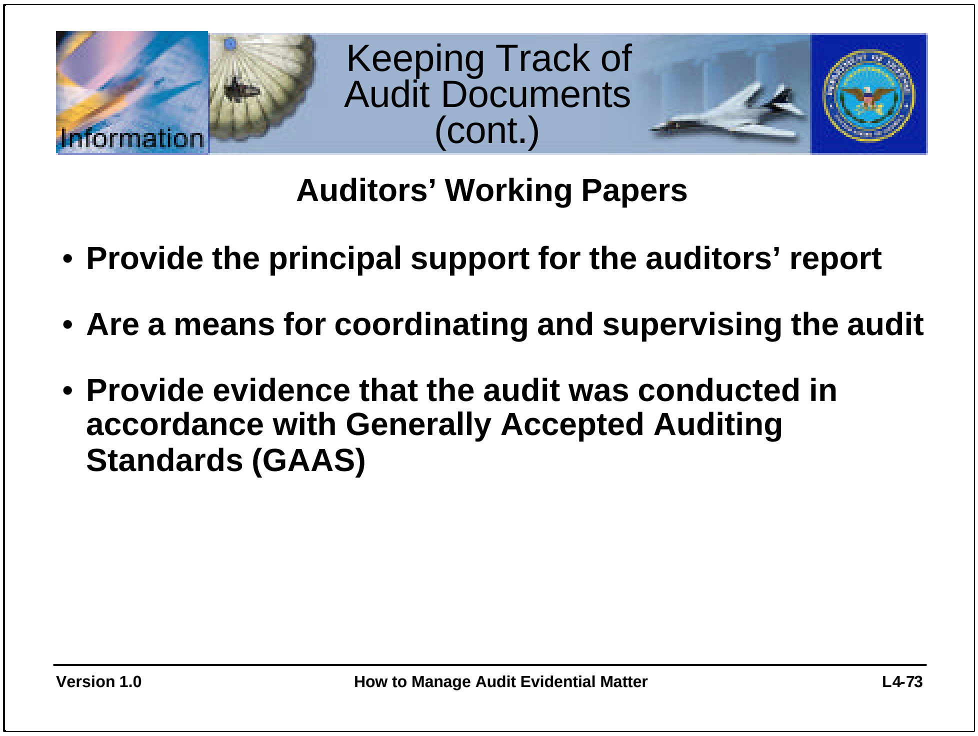
Keep copies of databases. Systems are constantly undergoing changes so you may be required to keep copies of databases that were working when the data was originally entered. Quarterly is a good time frame. Later the databases may change and therefore the information is not going to match. There are a lot of issues with systems; they are old and were not designed in accordance with GAAP; nevertheless, agencies still need to be able to explain why some systems cannot be audited, and compensating controls (manual processes) must be explained.

Once required files, documents, procedures, and reports are identified, train people to know how and where to get the right information. If you get information from other agencies, is it reliable? How was it prepared? Is it consistent between agencies? Is it sent electronically? If so, is supporting documentation available? Are cumulative reports accurate? Are daily reports checked and verified? Do they reconcile?

Use guidelines on how to handle documentation exceptions and alternatives that can replace mission originals. Pay attention to document retention requirements for financial purposes as opposed to inventory control purposes.

Let's look at the difference between documents maintained by your entity and the documents maintained by the auditor.



Information

Keeping Track of Audit Documents (cont.)

Auditors' Working Papers

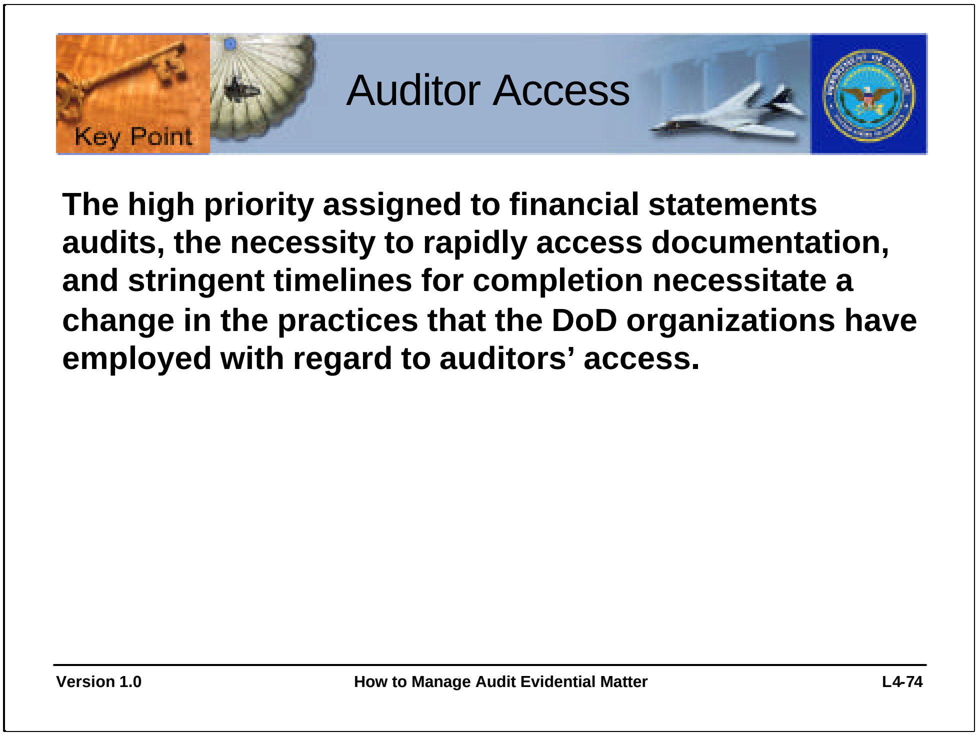
- **Provide the principal support for the auditors' report**
- **Are a means for coordinating and supervising the audit**
- **Provide evidence that the audit was conducted in accordance with Generally Accepted Auditing Standards (GAAS)**

Documents maintained by the auditors are called the audit working papers. Audit working papers are used to provide support for the auditors' report. They are a means for coordinating and supervising the audit, and provide evidence that the audit was conducted in accordance with Generally Accepted Auditing Standards (GAAS).

The working papers include records of requests for corroborating information and records of the information obtained, population statistics from which appropriate samples are selected, and completed checklists of inspections performed such as test counts of inventories, recalculation of reported data, and examination of documentary evidence. They also include schedules and analyses, a working trial balance from which records of adjustments are annotated and reported amounts are verified, and any memoranda or record of communication with the audited entity, including minutes of meetings, confirmation responses, written representations from management and outside experts, and copies of important contracts.

Selected documents from the working papers are maintained in the auditors' permanent files. These documents are typically items that include data that are expected to be useful to the auditors on any future engagements with your entity. These working papers belong to the auditors and they are responsible for maintaining confidentiality of those documents with the exception of certain legal requirements for access, such as access granted under summons from the IRS or courts of law. Some auditors are willing to share their cycle memos with the auditee. You may want to negotiate with the auditor to obtain them.

Now let's look at the requirement for auditors' access to the records maintained by your entity.



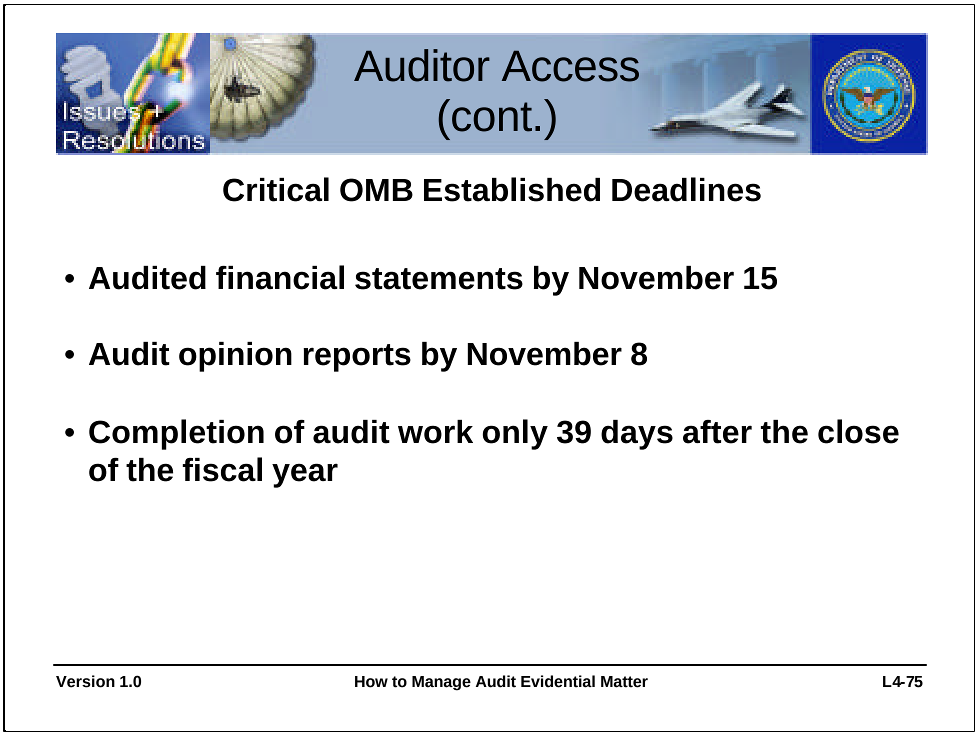
Auditor Access

The high priority assigned to financial statements audits, the necessity to rapidly access documentation, and stringent timelines for completion necessitate a change in the practices that the DoD organizations have employed with regard to auditors’ access.

The high priority assigned to financial statements audits, the necessity to rapidly access documentation, and stringent timelines for completion necessitate a change in the practices the DoD organizations have employed with regard to auditors’ access.

In this topic, you are exposed to the auditors’ access requirements to personnel and documentation for financial statements audits.

Let’s examine these changed requirements.


Issues + Resolutions

Auditor Access (cont.)

Critical OMB Established Deadlines

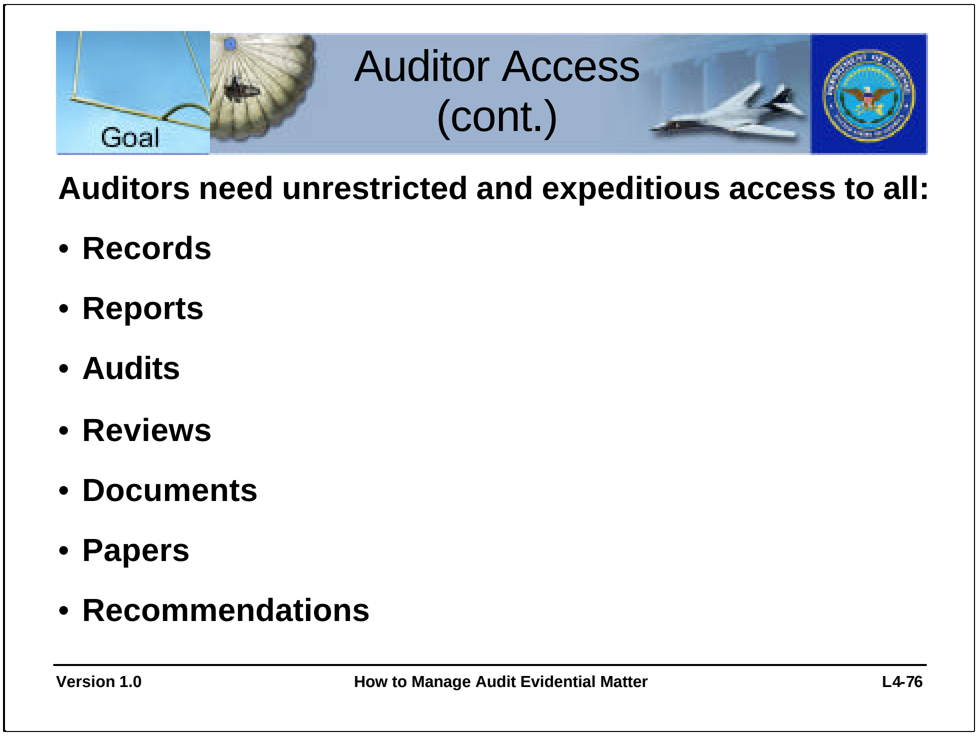
- **Audited financial statements by November 15**
- **Audit opinion reports by November 8**
- **Completion of audit work only 39 days after the close of the fiscal year**

The OMB memorandum dated October 18, 2002, established November 15 of each year as the deadline for all Executive Departments to submit their audited financial statements. In order to meet the November 15th deadline, the USD(C)/CFO requested the Office of the DoD OIG to provide audit opinion reports for all DoD Components by November 8 of each year. This is only 39 calendar days after the close of the fiscal year.

Even though much of the necessary audit work is accomplished during the nine months preceding fiscal year-end, significant work is required between the fiscal year-end and the November 8 submission deadline.

Accordingly, the DoD OIG urges the Defense Components, Agencies, and Field Activities to support the prompt and unrestricted access of financial statements auditors to required records, documents, and knowledgeable personnel. It also urges cooperation and support for the elimination of any existing restrictive practices.

Let’s look at what is meant by access to required records, documents, and knowledgeable personnel.



Auditor Access (cont.)

Auditors need unrestricted and expeditious access to all:

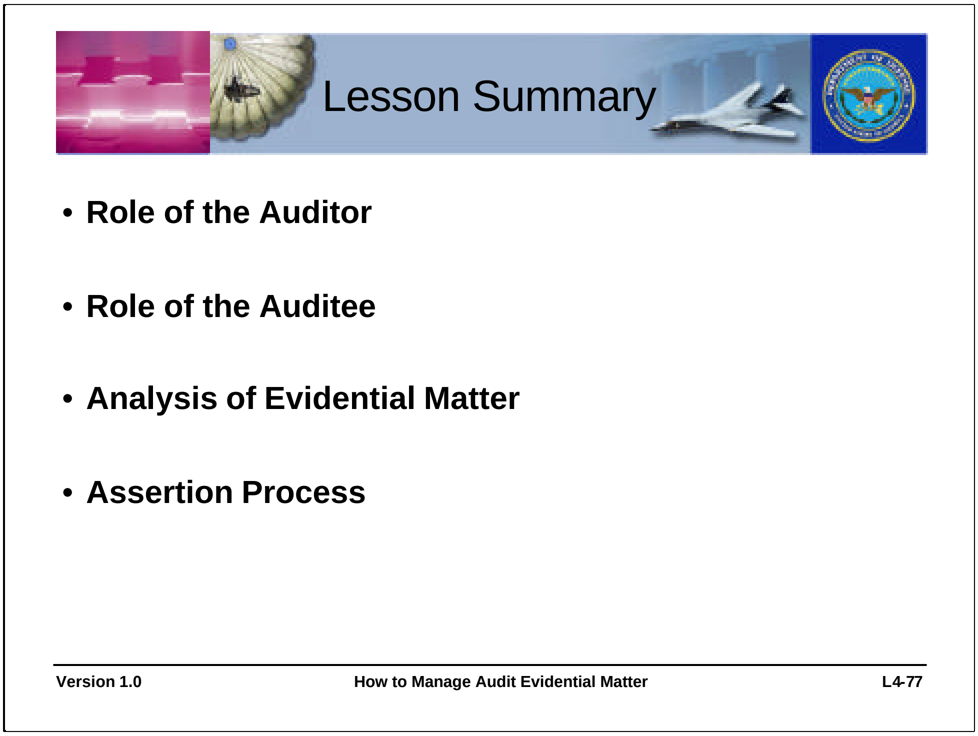
- **Records**
- **Reports**
- **Audits**
- **Reviews**
- **Documents**
- **Papers**
- **Recommendations**

In order to be able to express an opinion on financial statements, the auditors must be satisfied that the financial statements are supported by reasonable documentation. Financial statements audit work consists of examining the systems and processes that execute, document, record, classify, and report business transactions. Business transactions are recorded in accounting records; however, support for the transactions most often is with the operating organizations that execute the transactions. Therefore, financial statements auditors need access to many operational and support organizations, in addition to financial organizations.

One of the top priorities of the Secretary of Defense is obtaining unqualified audit opinions on the Department’s financial statements. To accomplish this goal within required timelines, financial statements auditors (service auditors, independent public accountants, and/or DoD OIG auditors) need unrestricted and expeditious access to all records, reports, audits, reviews, documents, papers, recommendations, or other material available to the applicable establishment.

Only by cooperating can we move the DoD closer to achieving its goal of obtaining unqualified audit opinions on its financial statements in the most efficient and effective manner.

Let’s summarize what we learned in this lesson.



Lesson Summary

- **Role of the Auditor**
- **Role of the Auditee**
- **Analysis of Evidential Matter**
- **Assertion Process**

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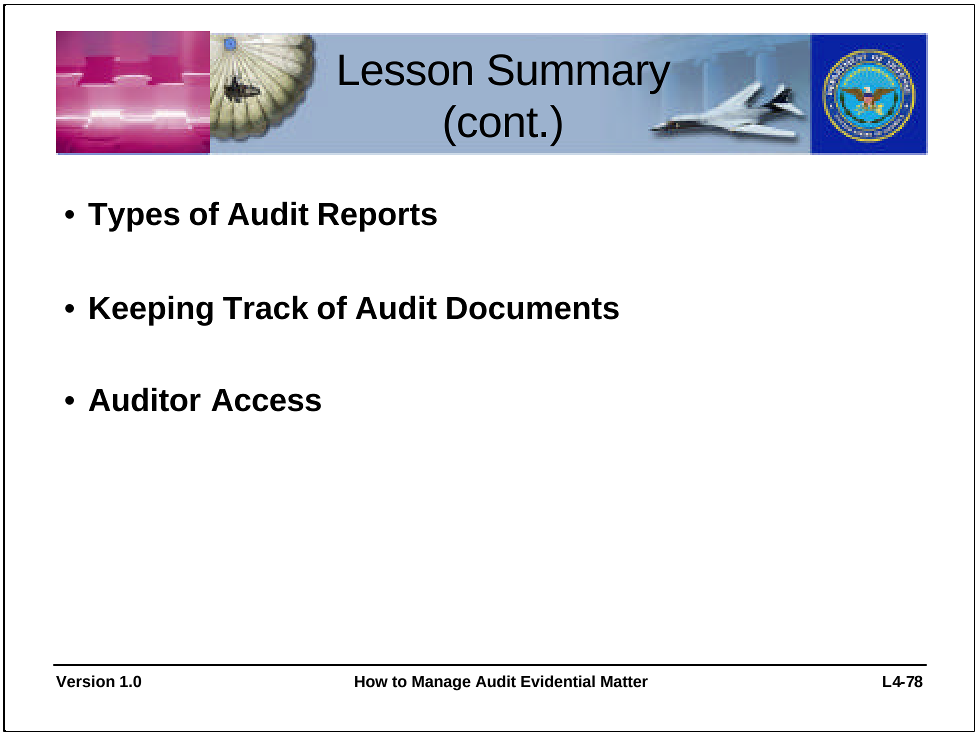
In this lesson, you learned that the auditors begin the audit by gaining a familiarity with your organization and it's operations. In gaining this understanding, the auditors may request various reports, assessments, procedures, and financial information. Once a sufficient understanding of your organization is obtained, the auditors assess the effectiveness of your internal control, plans and conducts tests of details of your transactions, and forms an opinion on the area under audit.

You learned that the role of the auditee is to provide sufficient, complete, valid, and accurate evidential matter.

You found that various types of analysis are used to ensure that the evidential matter is sufficient, complete, valid, and accurate, and that the key to the analysis of evidential matter is the determination of what is normal. You also found that tools used by the auditors, in the conduct of the audit, may be used by your entity in preparing for the audit

In discussing the assertion process, you discovered that the Financial Improvement Initiative is a five-phase process designed to improve your entity's ability to control and report on your financial activities. It includes the Discovery and Correction phase, the Validation phase, the Assertion phase, the Assessment phase, and the Audit phase.

Let's continue with the summary.



Lesson Summary (cont.)

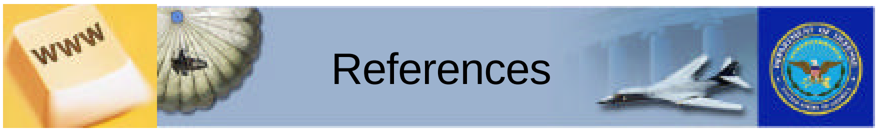
- **Types of Audit Reports**
- **Keeping Track of Audit Documents**
- **Auditor Access**

You found that the audit reporting is captured within the Audit Phase of the Financial Improvement Initiatives Business Rules. In discussing the types of audit reports, you learned why we report, what is required during the audit reporting phase of the financial statements audit, and the types of audit opinions.

You were given examples of various types of audit documents and procedures used to keep track of them both during and at the conclusion of the audit process. You learned that entity records include audit historical files and reports, audit findings and corrective actions, electronic files, minutes of audit meetings, and records of requests by the auditors. You also learned that the auditors' working papers provide the principal support for the auditors' report, are a means for coordinating and supervising the audit, and provide evidence that the audit was conducted in accordance with GAAS.

You found that the high priority assigned to financial statements audits, and more stringent timelines require the prompt and unrestricted access of financial statements auditors to required records, documents, and knowledgeable personnel.

The following slide list references available for additional information.



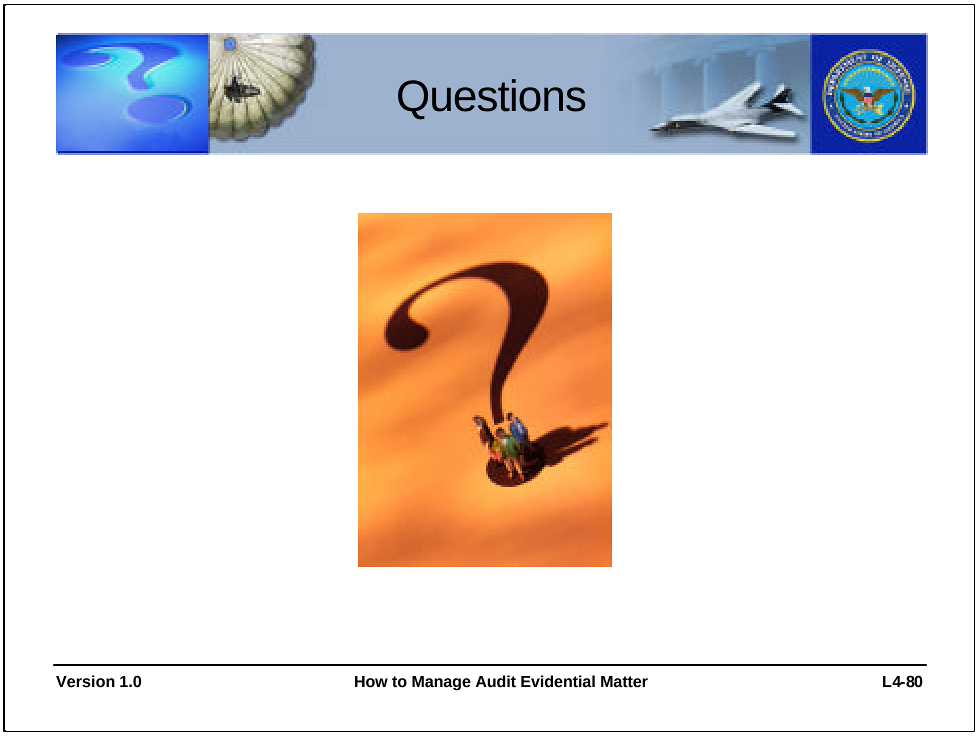
References

GAO/PCIE Financial Audit Manual: http://www.gao.gov

CFOA: http://wwwoirm.nih.gov/itmra/cfoact.html

FFMIA: http://www.gao.gov/new.items/d05225g.pdf

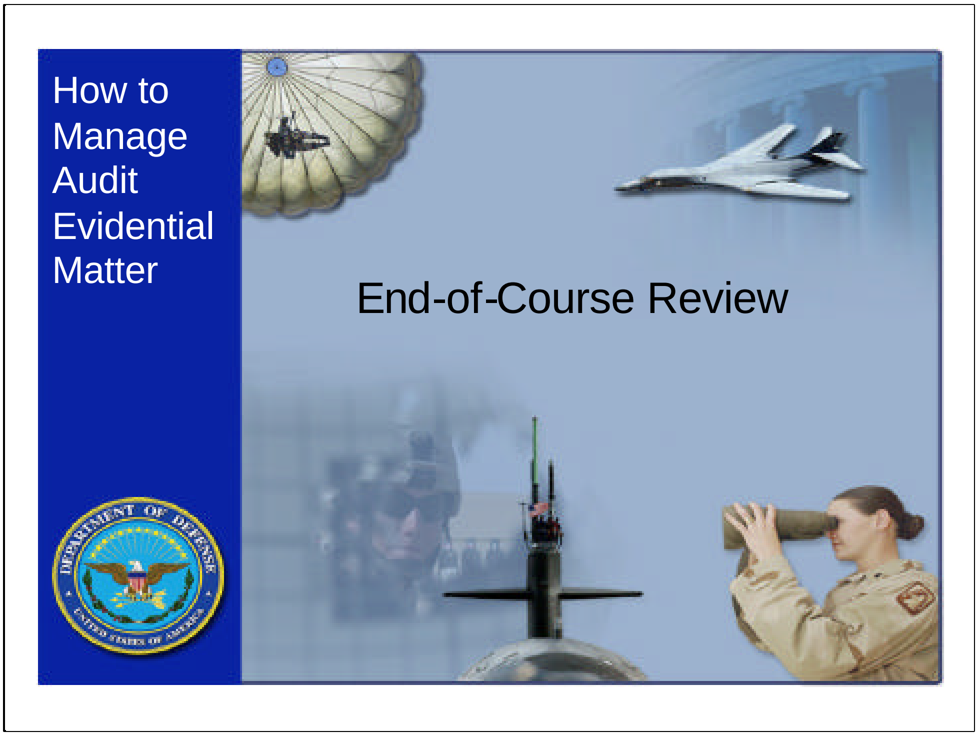
PAR: http://www.defenselink.mil/comptroller/par/



Questions

Version 1.0 How to Manage Audit Evidential Matter L4-80

Do you have any questions on the material covered in this lesson?



How to Manage Audit Evidential Matter

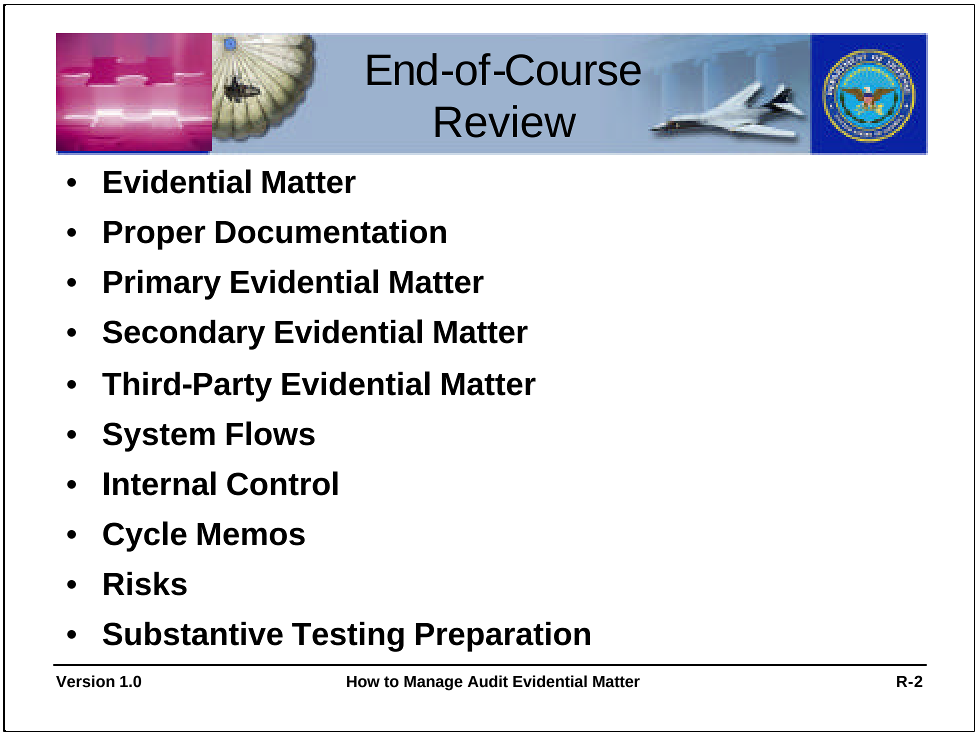
End-of-Course Review

This course is designed to help you understand how to prepare evidential matter that relates to the annually audited financial statements. In this course, you learned how to produce evidential matter by looking at examples of audit trails, proper source documentation and its impact on the audit trail, and substantive testing. You learned to differentiate between primary, secondary, and third-party evidential matter, and how it moves between subsidiary feeder systems and primary accounting systems. You saw how cycle memos document internal control processes, and how control activities and risk relate to internal control.

You examined the legislative and regulatory requirements with respect to the retention of evidential matter and discussed what affects the quality of the evidence. You were given best practice examples of proper file maintenance and how to capture and organize the evidential matter so that it is accessible to the auditors upon request. You learned the roles and responsibilities of the points of contact with respect to who keeps the evidential matter and where it is stored.

Once evidential matter is stored, you learned how to retrieve it for the purpose of the audit. You now understand your responsibilities to the auditors to provide the information requested on the PBC List and how to use document retrieval tools to obtain audit evidential matter. You found that once you have the evidential matter, you must determine your role and that of the auditors in managing the audit documentation.

Let’s summarize the topics covered within Lesson 1.



End-of-Course Review

- **Evidential Matter**
- **Proper Documentation**
- **Primary Evidential Matter**
- **Secondary Evidential Matter**
- **Third-Party Evidential Matter**
- **System Flows**
- **Internal Control**
- **Cycle Memos**
- **Risks**
- **Substantive Testing Preparation**

Version 1.0 **How to Manage Audit Evidential Matter** **R-2**

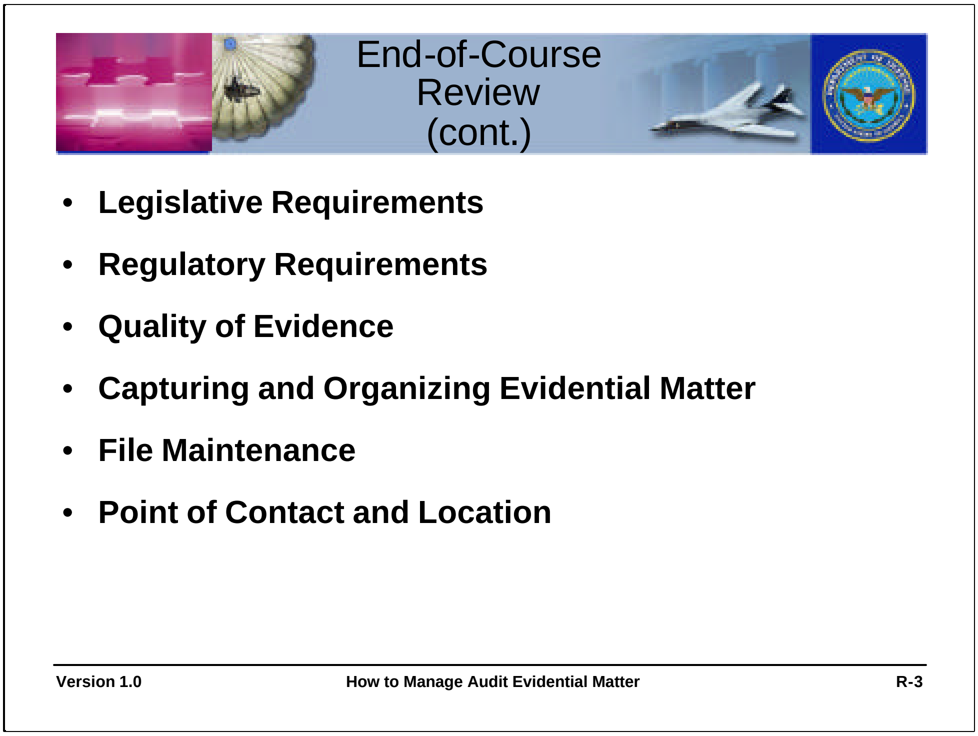
In Lesson 1, Producing Audit Evidential Matter, you learned about the types of documentary evidence that auditors use as evidential matter to support their audit opinions.

You learned that complete reliance on analytical evidence is improbable. You learned about primary, secondary, and third-party evidential matter and its impact on the auditors' opinion. System flows showed you how subsidiary data from financial systems, non-financial systems, manually-prepared compilations, and other direct inputs are the basis for the primary accounting system outputs.

Control activities and risk assessments were identified, as they relate to an organization's plans, methods, and procedures.

You learned how to produce cycle memos to document internal control processes.

You learned about the two types of substantive testing: analytical and detail. Analytical testing is a comparison of actual amounts to expected amounts. Detail testing involves corroborative evidence such as confirming, physically observing, examining, and recalculating supporting documents.



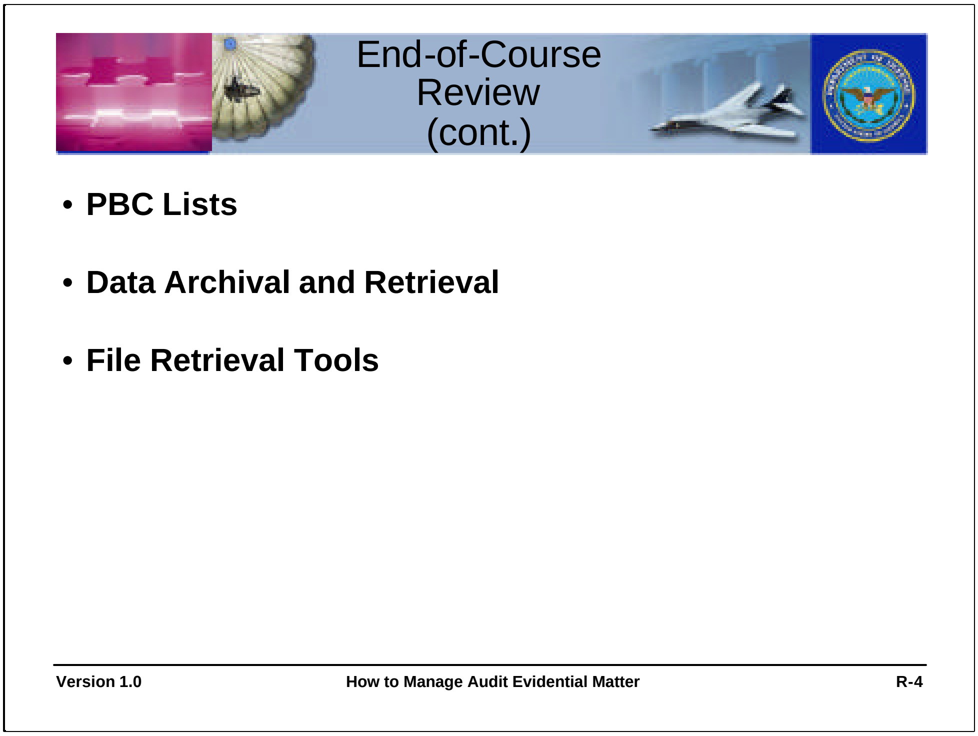
End-of-Course Review (cont.)

- **Legislative Requirements**
- **Regulatory Requirements**
- **Quality of Evidence**
- **Capturing and Organizing Evidential Matter**
- **File Maintenance**
- **Point of Contact and Location**

In Lesson 2, Retaining Audit Evidential Matter, you learned that the legislative requirements gave the authority to NARA to develop guidelines for record retention. These guidelines are translated to the regulations of the DoD, agencies, and installations.

You learned about the factors of relevance, source, timeliness, and objectivity that auditors look at to determine the competency and quality of evidential matter. You also looked at how DeCA was able to improve their business practices to obtain an unqualified audit opinion.

You observed a system of folders for the collection and retention of audit sensitive data. The importance of the POC operating at the individual locations was described with relation to a transaction.



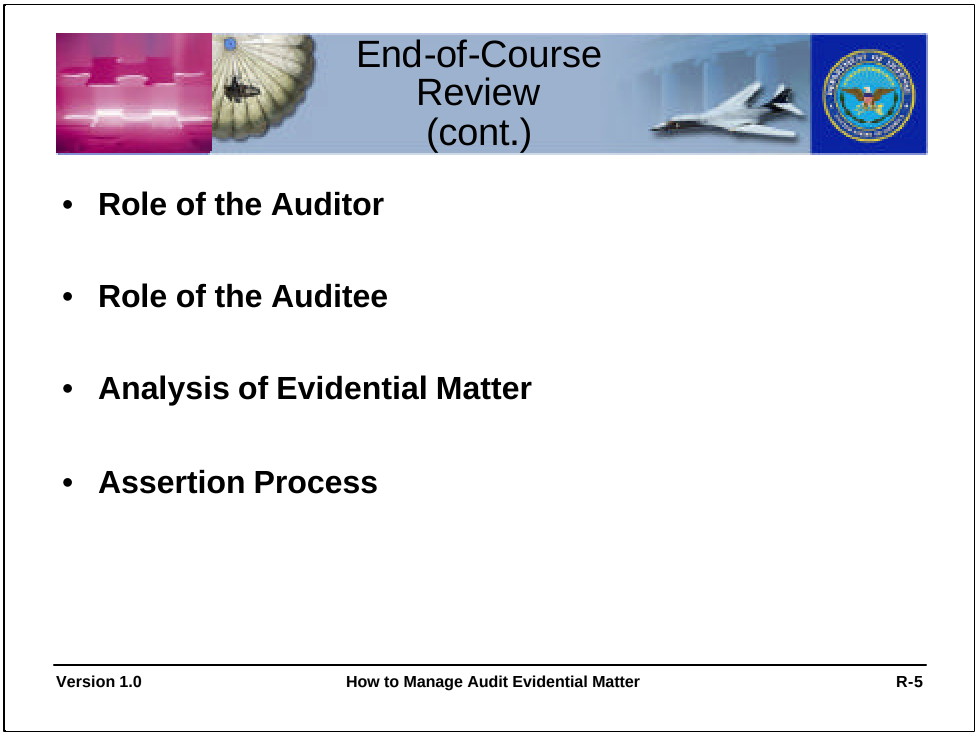
End-of-Course Review (cont.)

- **PBC Lists**
- **Data Archival and Retrieval**
- **File Retrieval Tools**

In Lesson 3, Retrieving Audit Evidential Matter, you learned that the PBC List is a checklist of requested documents or other deliverable items broken down into several categories and numbered for ease of reference. These items are required by the auditors to adequately audit your organization. The list provides a timeline and control sheet on the receipt of the requested information, and once completed, it serves as a resource for the audit team to determine who they can obtain further information from concerning the requested items.

When you understand the origin of an affected transaction, you can design a system query to recall the transaction detail, or you may already have selected queries that can be modified to fit the required data. You may have to trace the transaction to its originating certifying official to retrieve the supporting documentation. You then must review the retrieved transaction documents to ensure that they are complete. In a transaction that requires payment, you review for funding authorization; review the contract, the vendor's invoice, and receiving instrument; and review for certification and proof of payment. Copies of documents that are forwarded for audit and location of the original documents is annotated in the files until the originals are returned.

In discussing file retrieval tools, you found that the use of electronic media has greatly enhance the ability of the Department to access, manage, and view required documents and reports.



End-of-Course Review (cont.)

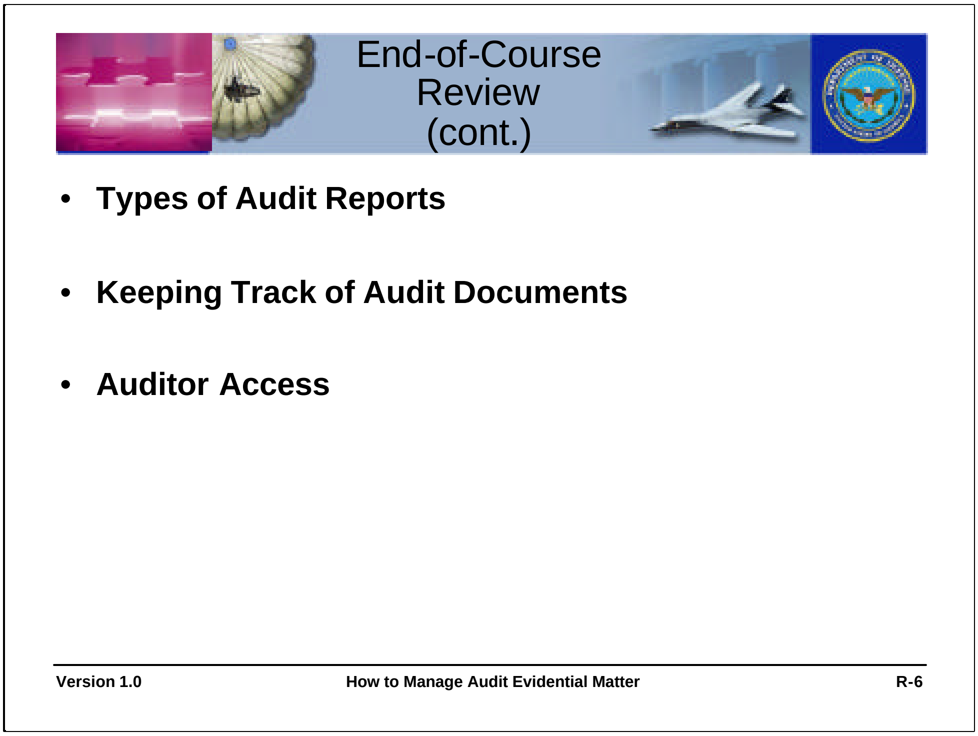
- **Role of the Auditor**
- **Role of the Auditee**
- **Analysis of Evidential Matter**
- **Assertion Process**

In Lesson 4, Presenting Audit Evidential Matter, you learned that the auditors begin the audit by gaining a familiarity with your organization and its operations. In gaining this understanding, the auditors may request various reports, assessments, procedures, and financial information. Once a sufficient understanding of your organization is obtained, the auditors assess the effectiveness of your internal control, plan and conduct tests of details of your transactions, and form an opinion on the area under audit.

You learned that the role of the auditee is to provide sufficient, complete, valid, and accurate evidential matter.

You found that various types of analysis are used to ensure that the evidential matter is sufficient, complete, valid, and accurate, and that the key to the analysis of evidential matter is the determination of what is normal. You also found that tools used by the auditor in the conduct of the audit may be used by your entity in preparing for the audit.

In discussing the assertion process, you discovered that the Financial Improvement Initiative is a five-phase process designed to improve your entity's ability to control and report on your financial activities. It includes the Discovery and Correction phase, the Validation phase, the Assertion phase, the Assessment phase, and the Audit phase.



End-of-Course Review (cont.)

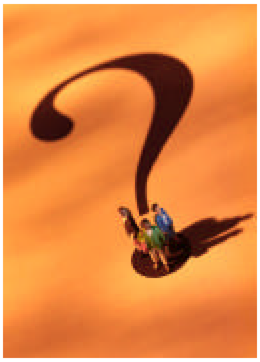
- **Types of Audit Reports**
- **Keeping Track of Audit Documents**
- **Auditor Access**

You found that the audit reporting phase is captured within the Audit phase of the Financial Improvement Initiatives Business Rules. In discussing the types of audit reports, you learned why we report, what is required during the audit reporting phase of the financial statements audit, and the types of audit opinions.

You were given examples of various types of audit documents and procedures used to keep track during and at the conclusion of the audit process. You learned that entity records include audit historical files and reports, audit findings and corrective actions, electronic files, minutes of audit meetings, and records of requests by the auditors. You also learned that the auditors' working papers provide the principle support for the auditors' report, are a means for coordinating and supervising the audit, and provide evidence that the audit was conducted in accordance with GAAS.

You found that the high priority assigned to financial statement audits and more stringent timelines require the prompt and unrestricted access of financial statements auditors to required records, documents, and knowledgeable personnel.

Questions



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Appendix A. Glossary

This glossary should serve as a reference tool for DoD personnel who need an understanding of auditing terminology. It is not all-inclusive and reflects both acronyms and terms introduced throughout this course.

ACES	Automated Civil Engineer System
Acquisition	To come into possession or control, by purchase or other means, of an asset or an improvement to an asset.
AcSEC	Accounting Standards Executive Committee (of the AICPA)
ADP	Automated Data Processing is the use of computer equipment to facilitate accounting, budgeting, and other processes.
AFCESA	Air Force Civil Engineering Support Agency
AICPA	American Institute of Certified Public Accountants
AIMD	Accounting and Information Management Division, GAO
Amortization	Periodic recognition of the consumption (expense) of an asset.
AR	Army Regulation
Assertion	Explicit and implicit information provided by management that attests to the represented financial position or results of operations
Assertion Letter	A representation by management that a financial statement or line item is ready for audit
Asset	Property owned by an entity. Assets are classified in several ways, including assets that are tangible and intangible. While tangible assets are more easily defined, intangible assets are those long-lived assets useful in the operation of entity that are not held for sale and have no physical qualities. Examples of intangible assets include patents, copyrights, franchises, trademarks, trade names, and goodwill.
AT&L	Acquisition, Technology, and Logistics is an office located within the Office of the Secretary of Defense.
Auditable	The condition where underlying data and procedures are sufficient, accurate, testable, and reliable enough for an auditor to obtain a basis for forming an unqualified opinion

Audit Ready	The condition where underlying data is auditable and the staff is ready to support that data in an audit process.
Audit Risk	A risk taken when an auditor unknowingly fails to modify his or her opinion appropriately on financial statements that are materially misstated.
Audit Trail	A chain of evidence provided by coding, cross-references, and documentation connecting account balances and other summary results with original transaction data.
BEA	Business Enterprise Architecture is a mechanism to better manage the Department's business operations and to structure the complex systems and organizational interrelationships. (see BMMP)
Benchmark	A standard against which others are measured.
Best Practice	A process or procedure that can be used as a good example for others in similar organizations
BMMP	The Business Management Modernization Program is a vehicle designed to transform business operations and improve oversight and accountability for the billions of dollars spent designing, building, operating, and maintaining business systems and processes that support the Department's primary missions.
BOD	Beneficial Occupancy Date (also Date Placed in Service)
BRAC	Base Realignment and Closure is the Congressional mandate to eliminate excess physical capacity, the operation, sustainment, and recapitalization of that which diverts scarce resources from Defense capability.
CADD	Computer-aided Drafting and Design
Capitalize	To record and carry forward into one or more future periods any expenditure from which the benefits will then be realized.
CEFMS	Corps of Engineers Financial Management System
CFO	A Chief Financial Officer is an organization's senior financial executive.
CFOA	The Chief Financial Officers Act of 1990 is intended to improve financial management systems and information to produce timely, reliable, and comprehensive financial information.
CFOC	The Chief Financial Officers Council is an organization of the CFOs and Deputy CFOs of the largest federal agencies, senior officials of the Office of Management and Budget, and the Department of the Treasury, who work collaboratively to improve financial management in the U.S. government.

CIP	Construction-in-Progress is an asset in the process of completion.
Completeness Assertion	An assertion about whether all transactions and accounts that should be presented in the financial statements are so included.
Compliance	The conformity to the rule of law, standard practice, or specified procedure.
COTS	Commercial Off-the-Shelf – Software
Cycle Memorandum	A depiction in words and/or a diagram form of the activities relating to a particular type of transaction such as the revenue cycle, expenditure cycle, financing cycle, personnel services cycle, or production cycle.
DCAA	The Defense Contract Audit Agency is responsible for performing all contract audits for the Department, and providing accounting and financial advisory services regarding contracts and subcontracts to all DoD components responsible for procurement and contract administration.
D.C. or DC	District of Columbia
DD	Department of Defense form prefix
DeCA	The Defense Commissary Agency delivers quality of life benefits to the armed services community by efficiently and effectively providing products and services at a lower cost than that available in the retail sector.
Depreciation	The allocation of the cost of an asset over a period of time for accounting and/or tax purposes.
DFARS	Defense Federal Acquisition Regulation Supplement
DFAS	The Defense Finance and Accounting Service has the central mission to provide responsive, professional finance and accounting services for the people who defend America.
Deficiency	In an audit, the term deficiency describes a lack in adequate competence, readiness, knowledge, or means. It may be synonymous with fault or defect.
Disclosure	Making something known to the public, as in disclosing the financial position of an entity through the publishing of its financial statements and accompanying notes.
DLA	The Defense Logistics Agency provides worldwide logistical support for the missions of the military departments and the Unified Combatant Commands under conditions of peace and war. It also provides logistics support to other DoD components and certain federal agencies, foreign governments, international organizations, and others as authorized.

DoD	Department of Defense (also referred to as the Department)
DoDD	Department of Defense Directive
DoDFMR	Department of Defense Financial Management Regulation (7000.14-R)
DoD OIG	Department of Defense Office of Inspector General
DWCF	Defense Working Capital Fund
EDA	Electronic Document Access
EDM	Electronic Data Management
ENG	Engineering
Engagement	Describes the process of conducting an audit; the formal agreement to provide a service, as in an audit engagement letter or contract.
Entity	An organization, unit, or body, such as a department, fund, agency, or section.
ESC	Executive Steering Committee
Evidential Matter	Audit evidence that consists of underlying accounting data or financial records and all corroborating information available to an auditor.
Existence Assertion	An assertion about whether assets or liabilities of an entity exist at a given date, and whether recorded transactions have occurred during a given period; also called existence occurrence.
Existence Occurrence	See Existence Assertion.
FAM	The Financial Audit Manual was established by the GAO and the PCIE to ensure that the financial statement audits have their intended outcome.
FAR	The Federal Acquisition Regulation is the official authoritative source for the contracting community.
FASAB	The Federal Accounting Standards Advisory Board promulgates federal accounting standards to support financial and budgetary information needs of citizens, congressional oversight groups, executive agencies, and the needs of other users of federal financial information.

FASB	The Financial Accounting Standards Board establishes and improves standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information. It is officially recognized as authoritative by the Securities and Exchange Commission and the American Institute of Certified Public Accountants.
FFMIA	The Federal Financial Management Improvement Act builds on the CFO Act by requiring agencies to have systems that can generate timely, accurate, and useful information with which to make informed decisions and to ensure accountability.
FII	The Financial Improvement Initiative promotes the achievement of an unqualified opinion on the Department's consolidated financial statements.
FISCAM	Federal Information System Controls Audit Manual
FMFIA	The Federal Manager's Financial Integrity Act requires federal managers to establish a continuous process for evaluating, improving, and reporting on the internal control and accounting systems for which they are responsible. It furthers requires that, each year, the head of each executive agency subject to the Act shall submit a report to the President and Congress on the status of management controls and financial systems that protect the integrity of agency programs and administrative activities.
FMMP	The Financial Management Modernization Program was renamed the BMMP on May 20, 2003 (see BMMP).
FMR	Financial Management Regulation (see DoDFMR)
FMS	The Foreign Military Sales program manages government-to-government purchases of weapons and other defense articles, defense services, and military training.
FUDS	Formally Used Defense Sites is a classification of sites for the purpose of environmental cleanup.
FY	Fiscal Year
G&A	General and Administrative
GAAP	Generally Accepted Accounting Principles are the common set of accounting principles, standards, and procedures. GAAP is a combination of authoritative standards (set by policy boards) and the accepted ways of performing accounting.
GAGAS	Generally Accepted Government Auditing Standards

GAO	The Government Accountability Office, previously called the General Accounting Office, is an independent agency that works for Congress. The GAO is often called the "congressional watchdog" because it investigates how the federal government spends taxpayers' dollars.
GMRA	The Government Management Reform Act of 1994 updated the CFOA by setting standards for the effectiveness of financial management reporting.
GOCO	Government-Owned, Contractor-Operated facilities and equipment.
GPRA	The Government Performance and Results Act of 1993 aims to improve federal program effectiveness and public accountability by promoting a new focus on results, service quality, and customer satisfaction.
GRS	The General Records Schedule is issued by the Archivist of the United States to provide disposition authorization for records common to several or all agencies of the federal government.
GS	General Schedule is a classification for civilian employment.
GSA	General Services Administration
IAW	In accordance with
ID	Identification (see UID)
IG	The Inspector General has traditionally served as "an extension of the eyes, ears, and conscience of the Commander." Pursuant to the Inspector General Act of 1978, as amended, "the Inspector General of the Department of Defense shall . . . be the principal adviser to the Secretary of Defense for matters relating to the prevention of fraud, waste, and abuse in the programs and operations of the Department." (see OIG)
IGT	Intergovernmental Transaction
IMPAC	International Merchant Purchase Authorization Card
IPA	Independent Public Accountant
Internal Control	Processes that are designed to provide reasonable assurance regarding the achievement of objectives in the reliability of financial reporting, compliance with applicable laws and regulations, and the effectiveness and efficiency of operations.
Internal Review	An inspection of processes and data of an entity by personnel employed by or internal to the entity.

JFMIP	The Joint Financial Management Improvement Program is a joint and cooperative undertaking of the Department of the Treasury, the GAO, the OMB, and the OPM working in cooperation with each other and other agencies to improve financial management practices in government.
Liability	A legal responsibility for an amount owed.
Materiality	In an audit, materiality refers to the degree of importance or consequence.
MC	Management Control (see also MCP)
MCP	A management control program provides reasonable assurance that obligations and costs comply with applicable laws and emphasizes prevention of waste, fraud, mismanagement, and timely corrections of MC weaknesses.
MDA	The Management Discussion and Analysis section, found on financial statements, allows management to discuss aspects of an entity's financial statement that may be otherwise difficult to locate. It provides a summary and more.
MFR	Memorandum for Record
MILCON	Military Construction is based on funds provided by Congress.
MIPR	Military Interdepartmental Purchase Request
MOU	A Memorandum of Understanding is a formal, signed agreement.
N/A	Not available (or Not applicable)
NARA	The National Archives and Records Administration ensures ready access to essential evidence and prescribes standards relating to retention of documents.
NATO	North Atlantic Treaty Organization
NAVFAC	Naval Facilities Engineering Command
NDPP&E	National Defense PP&E property is used in active Military Activities and previously expensed in the period incurred, now classified as general PP&E and capitalized, with the exception of the cost of land and land improvements that produce permanent benefits. Land improvements are depreciated.
No.	Number

Non-statistical Sampling	A group of methods used in audits to determine the size of a sample to be tested and the evaluation of the results that is less objective and more subjective and judgmental than the statistical sampling approach.
NRV	Net Realizable Value is a valuation method.
O&M	Operations and Maintenance
OCONUS	Outside continental United States
OFFM	The Office of Federal Financial Management was created within the OMB by the CFOA of 1990. The OFFM is responsible for the financial management policy of the federal government including implementing the financial management improvement priorities of the President, establishing government-wide financial management policies of executive agencies, and carrying out the financial management functions of the CFOA.
OIG	Office of Inspector General (see IG)
OLRV	On-line Review
OMB	The Office of Management and Budget has a mission to assist the President in overseeing the preparation of the federal budget and to supervise its administration in Executive Branch agencies.
OM&S	Operations, Maintenance, and Supplies
OPM	The Office of Personnel Management is the federal government's human resource agency.
OUSD(C)	Office of the Under Secretary of Defense (Comptroller)
OUSD(HA)	Office of the Under Secretary of Defense (Health Affairs)
P&EP	Property and Equipment Policy
PARS	Performance and Accountability Reports
PBC	A Prepared by Client list is a list that facilitates the audit process by coordination with specific points-of-contact.
PCIE	The President's Council on Integrity and Efficiency was established to address integrity, economy, and effectiveness issues that transcend individual government agencies, and increase the professionalism and effectiveness of IG personnel throughout the government.

PMA	The President's Management Agenda is the strategy that the current administration has for improving the management of the federal government. It focuses on five areas of management weaknesses across the government where improvements and the most progress can be made.
PMO	Program Management Office
POC	A Point of Contact is generally a person responsible for providing information or service.
Population	A class of transactions or the account balance to be tested in an audit.
PP&E	Property, Plant, and Equipment is a classification of property for the entity's financial statements.
Qualified Opinion	An auditor's opinion stating that except for the effects of the matter(s) to which the qualification relates, the financial statements present the position of the organization fairly.
Readiness	See Audit Ready.
Reasonable Assurance	Assurance that a reasonable person can reach the same conclusion given the same data and circumstances; not an absolute certainty.
RFA	Ready for Audit
Rights and Obligations Assertion	An assertion about whether assets are the rights of the entity, and liabilities are the obligations for the entity, at a given date.
Risk Adverse	A condition in which an auditor is not willing to accept a moderate or high level of audit risk, usually when the client has a greater likelihood of financial failure or there are many users of the statements and audit reports.
ROS	Reports of Survey
RPC	Review and Prioritization Committee
RPS	Review and Prioritization Sub-committee
Sample	A single unit within a class of transactions or account balances to be tested.
SAS	Statements on Auditing Standards
SEC	Securities and Exchange Commission
SECDEF	Secretary of Defense

SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards is the standards issued by the FASAB to implement the GAAP for the federal government.
SGL	The Standard General Ledger is the chart of accounts used by the Department to properly record all accounting transactions.
SOP	Standard Operating Procedure
Source Documentation	Documents representing authorization for original transactions and associated with transaction data. These documents include contracts, invoices, funding authorizations, bills of lading, receiving reports, titles, mortgages or notes, leases, agreements, appointments, signature cards, policies, and others.
Statistical Sampling	A mathematical method or combination of methods used to determine the number of items in a population to examine.
Systemic	Describes a problem involving one or more financial reporting systems that results in an inability to provide accurate, reliable, or timely financial data.
TDY	Temporary Duty
TFM	Treasury Financial Manual
TI	Treasury Index is the Treasury's code for the various funds used in the federal government. Examples in DoD include TI 97, 57, 21, and 17.
UID	Unique Identifier
Unqualified Opinion	An auditor's opinion that is without any material exception as to a general statement of reliability of the items specified within the limits of an audit.
U.S. or US	United States
USD	Under Secretary of Defense
USD(C)	Under Secretary of Defense, Comptroller
USSGL	United States Standard General Ledger provides a uniform Chart of Accounts and technical guidance to be used in standardizing federal agency accounting.
USTRANSCOM	The United States Transportation Command is a unified command composed of elements from each of the services to provide air, land, and sea transportation for the DoD.

Validation	The corroboration, substantiation, or confirmation of relevant or meaningful information, supported by objective truth or generally accepted authority.
WCF	The Working Capital Fund was established to be self-sustaining where products or services are produced and sold to recover the full cost of operations.

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Appendix B. Assertion Package Organization and Review Criteria

The following is the Assertion Package and Review Criteria as of 8/17/04:

TAB	TOPIC	CHECK LIST STEP
1	Process Cycle Memos and Flow Charts	1
2	GL Transaction Detail/Support	2
3	Evidential Matter	3
4	Validation Summary (Management Assertion Letter, Completed Assertion Checklist, and Validation Work Products such as completed GAO Checklists, etc.)	4
5	Status of FIP Corrective Actions	5
6	Summary of Corrective Actions Taken	6
7	Organization Charts/Contact Lists	7
8	FISCAM and SAS 70/88 Audit Date(s) and POCs	8
9	FISCAM and SAS 70/88 Audit Results	9
10	Hardware, Software, and Interfaces	10
11	Type of Data Produced	11
12	Telecom/Network Information	12
13	Certifications/Accreditations	13
14	System/End User Locations	14
15	Location of Systems Documentation	15
16	Data Type/Summary of Transactions (Number, Type, Dollar Value)	16
17	List of Authorized Users	17
18	List of On-Going or Planned Reviews	18

v	Step	Description	Assertion Package Tab	Evaluation Criteria
	1	Identify and document the procedures, processes, and control points for deriving the balance(s) being asserted. Include the systems that are used and the flow of data from field level to departmental level. This can be done in a cycle memorandum or flow chart format. Having this information prepared in advance will be a great tool for you to refer to during the assessment and audit. Also, the auditors will need to document the information so you will already have the information prepared. Be sure to identify all systems that have detail that make up the balance(s) being asserted as ready for audit.	Place cycle/process memorandum, flow documents, questionnaires, directives, and procedures at **TAB 1** of the assertion package.	A flowchart(s) is required for each major process and a cycle/process memorandum (a description of a cycle memorandum is in the GAO Financial Audit Manual Section 390.04, "Cycle Memorandum and Flowchart") should be provided to: accurately describe the regulations followed for the process, document procedures utilized, document key control techniques, identify systems used at the departmental level, and include the management control objectives and risk assessments. Review the flowchart(s), cycle/process memorandum, and supporting documents for reasonableness and completeness for each process listed.
	2	Have all General Ledger transaction detail and supporting information from feeder systems available for all other transactions that make up the balance(s) being asserted. Ensure the total of the detail equals the balance of the line item. This includes all accounting adjustments that have an effect on the ending balance of a line item reported on the financial statements.	Place supporting GL transaction detail information at **TAB 2** of the assertion package.	Review the provided detailed description/flow chart of the reconciliation process performed. The detailed description should describe how the line item balance is fully supported by the General Ledger, the General Ledger is fully supported by the Subsidiary Ledgers, and each transaction in the Subsidiary Ledgers is supported by the appropriate supporting evidential matter. The description should demonstrate that the data is readily available and should provide POCs for the data.
	3	Consolidate evidential matter that supports the transactions in step 2 or map where the evidential matter is located for easy and expedient retrieval.	Where practical, include Evidential Matter at **TAB 3**, if space does not permit, include detailed information of where the evidential matter is located.	Review the description of the supporting evidential matter (i.e. contracts, invoices, receiving reports, etc.) for reasonableness and completeness. Verify that the location of the supporting evidential matter is identified.

v	Step	Description	Assertion Package Tab	Evaluation Criteria
	4	Prepare a summary of validation work performed by management Service auditors, Internal auditors, or independent public accounting firms to establish audit readiness, as applicable.	Place Validation Summary, the Management Assertion Letter, the completed assertion package checklist, and validation work products in **TAB 4**.	Verify the presence of the Management Assertion Letter. Verify Validation Summary is present, describes validation methodology, and appears reasonably complete and accurate. Verify the separation of duties between the persons generating the assertion packages and the persons validating the assertion packages. If separation of duties does not exist, review the adequacy of management's explanation of why it deemed separation of duties was not needed.
	5	Complete all the corrective actions in your Mid-Range Financial Improvement Plan (FIP) for the material deficiencies related to the balance(s) being asserted.	Place a statement in **TAB 5** that all corrective actions in the FIP related to material deficiencies associated with this line are completed.	Verify that the Management Assertion letter includes a statement that corrective actions identified in the FIP are completed. Also include the comprehensive corrective action plans for identified deficiencies if not part of the FIP.
	6	Using the information from step 5 above, prepare an explanation of the actions taken to fix previously identified or existing problems and incorporate the explanation in the assertion letter or include as attachment to the letter. Be very specific.	Place a status of all FIP corrective actions related to the assertion in **TAB 6**.	Verify that the Validation Summary includes: • a summary of the corrective actions completed for all known material weaknesses and reportable conditions related to the assertion, OR • a reference to the FIP which documents the completion of all corrective actions related to the assertion.

v	Step	Description	Assertion Package Tab	Evaluation Criteria
	7	Compile organization charts indicating key personnel and their responsibilities and phone lists.	Place organization charts at **TAB 7** of the assertion package.	Verify that the packages include organization charts for the financial and information technology process owners. The responsible key Government and contractor personnel and their location and contact information should be provided.
	8	For all the systems identified in step 1 above, has there been a Financial Information Security Audit Manual Controls (FISCAM) or Statement of Auditing Standard (SAS) 70/88 audit conducted on the systems? • If yes, provide the date and point of contact and proceed to step 9. • If no, proceed to step 10.	Place FISCAM / SAS Audit date and POC info at **TAB 8** of the assertion package.	Review to verify that the packages include dates and POC info for any FISCAM or SAS 70/88 audit reports on systems identified in step 1.
	9	For the Systems identified in step 1 that you answered Yes in step 8, obtain a copy of the FISCAM or SAS 70/88 audit report and skip the rest of the steps. For the systems identified in step 1 that you answered No in step 8, proceed to step 10. If a FISCAM or SAS 70/88 audit has not been conducted on the system, then the auditors will have to perform alternate procedures on the system. Therefore, the information in steps 10-18 will have to be gathered prior to the audit of each system	Place Audit Report(s) at **TAB 9** of the assertion package.	Review to verify that FISCAM or SAS 70/88 audit reports are present for all systems identified in step 1. If no audits were performed go to steps 10-18.

v	Step	Description	Assertion Package Tab	Evaluation Criteria
	10	Prepare a description of the major hardware and software of the system and interfaces with other systems.	Place at **TAB 10** of the assertion package.	Verify that for each system identified in step 1, a description of the hardware and software is provided. This description should include interface descriptions. At a minimum, the location of the document containing this information should be provided.
	11	Describe what type of data the system produces for the financial statements, e.g., accounting transactions.	Place at **TAB 11** of the assertion package	Verify that for each system identified in step 1, a description of the type of data the system produces is provided. At a minimum, the location of the document containing this information should be provided.
	12	Prepare a description of telecommunications devices and networks used with the system.	Place at **TAB 12** of the assertion package	Verify that for each system identified in step 1, a description of the telecommunications devices and networks used with the system is provided. At a minimum, the location of the document containing this information should be provided.
	13	Obtain a copy of the most recent certifications and accreditations of the system.	Place at **TAB 13** of the assertion package	Verify that for each system identified in step 1, a copy of the most recent certifications and accreditations of the system is provided. For example, this should include the identification of when the last DoD Information Technology Security Certification and Accreditation Process (DITSCAP) certification and accreditation was performed and include a copy of the most recent Systems Security Authorization Agreement (SSAA). At a minimum, the location of the reports, reviews, certifications and accreditations should be provided.

v	Step	Description	Assertion Package Tab	Evaluation Criteria
	14	Identify the system location(s) and end user locations.	Place at **TAB 14** of the assertion package	Verify that for each system identified in step 1, a description of the system location(s) and end user locations is provided. At a minimum, the location of the document containing this information should be provided.
	15	Identify the location(s) of system documentation.	Place at **TAB 15** of the assertion package	Verify that for each system identified in step 1, location of system documentation is provided.
	16	Identify the type, dollar value, and number of transactions processed in the system in a month and in a year.	Place at **TAB 16** of the assertion package	Verify that for each system identified in step 1, provide a description of the type, dollar value, and number of transactions processed in the system in a month and in a year is provided. In addition, the Component should identify which transactions are material to the assertion. At a minimum, the location of the document containing this information should be provided.
	17	List the type of system users – a type of user would be described as a certain category of employees or an organizations activity with-in an Agency.	Place at **TAB 17** of the assertion package	Verify that for each system identified in step 1, system user access information (locations and number of users per location) or a description of the types of users is provided. At a minimum, the location of the document containing this information should be provided.
	18	Inquire if there are any ongoing or planned system reviews – if there are, determine when the reviews will be complete.	Place at **TAB 18** of the assertion package	Verify that for each system identified in step 1, a description any ongoing or planned system review, as well as planned completion dates, is provided. In addition to the system reviews discussed in Steps 8 and 13, also include a copy of the most recent Financial Management Improvement Act (FFMIA) compliance review, DISA readiness reviews, or any other reviews that are ongoing or planned.

Office of the Under Secretary of Defense (Comptroller) (OUSD(C))

DEPARTMENT OF DEFENSE
UNITED STATES OF AMERICA

How to Manage Audit Evidential Matter

Final Examination

Student Name: ___________________________

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Final Examination

Directions	This is an open-book final examination covering subject matter taught in the How to Manage Audit Evidential Matter course. It will assess your knowledge of the general subject matter and requirements for managing audit evidential matter. This final examination consists of questions that are multiple choice and fill in the blank. Write in or circle the correct answer to the questions.
Time Allocation	The time allocated to this examination is 40 minutes: 30 minutes for the exercise and 10 minutes for the critique.

Number	Question
1	The two types of evidential matter are____________ and ____________. a. internal, external b. underlying accounting data, corroborating information c. real, hard copy d. reliable, unreliable
2	An audit trail provides information ________________________________. a. to physically track any single transaction from its inception to its appearance in the financial reports and statements b. from the financial reports and statements back to the source documents c. Both a and b d. Neither a nor b
3	Documentary evidence that is circulated to external parties is____________. a. more reliable than internally generated documents b. less reliable, as it is more susceptible to fraudulent statements c. not detailed enough to provide reliable evidential matter d. difficult to read and not to be trusted

Number	Question
4	Substantive assurance applies appropriate variables such as______________. a. confirmation, physical observation, and recalculation to detailed tests to determine the validity of information b. sample size, characteristics of population, level of materiality, and acceptable level of risk to a complex mathematical formula c. primary, secondary, and third-party evidential matter to support an audit opinion d. All of the above
5	Cycle memos are used by auditors to document________________________. a. internal control processes b. the accounting cycle c. audit trails from start to finish d. transactions in the proper time period
6	Control activities are____. a. a comparison and assessment of different sets of data for detailed tests b. internal activities that help ensure that management directives are carried out c. edit checks of substantive testing d. the separating, processing, recording, and reviewing of duties of audit personnel
7	You must identify risks within which categories of control objectives in order to estimate the likelihood of the occurrence of risk? a. Recording, processing, and summarization b. Economy, efficiency, and effectiveness c. Financial reporting, compliance, operations d. All of the above

Number	Question
8	What government entity is responsible for adequacy of documentation and record disposition? a. Office of Management and Budget b. National Archives and Records Administration c. General Services Administrative d. Department of Defense
9	List the four factors that affect the quality of evidential matter. ____________________________ ____________________________ ____________________________ ____________________________
10	List three software packages that provide query tools for document retrieval. ____________________________ ____________________________ ____________________________
11	What process can you use to provide the auditors with a better understanding of who keeps what when finding required evidential matter? a. FAM Checklist b. NARA c. Flowcharting d. SOP

Number	Question
12	What document, when submitted by the auditors, provides a timeline and control sheet for requested information to be provided by the client? a. PBC List b. IPA List c. CPA List d. IRA List
13	In performing financial statements audits, what is the responsibility of the auditors? a. To plan the audit and obtain relevant information on the effectiveness of your entity's internal control b. To conduct tests and report the results c. Both a and b
14	What techniques are used by the auditors to analyze physical evidence? a. Direct inspection and observation b. Inquiry, interview, and questionnaire c. Comparison, ratios, and expected relationships d. Examination of documents supporting the physical assets
15	In what phase of the Financial Improvement Initiative Business Rules does the entity communicate to the DoDIG the reliability of the financial information? a. Discovery and Correction b. Validation c. Assertion d. Assessment